THE ROLE OF THE CENTRAL BANK IN AN ISLAMIC BANKING SYSTEM

Mohammed Bassam Hashim Al Sayed

Submitted to University Of Wales in fulfillment of the requirements for Degree of

Doctor of Philosophy

University Of Wales, Lampeter
2005

ABSTRACT

The last two decades have witnessed the growth of Islamic banks in many Islamic countries. The conventional central banks were not competent enough to supervise and monitor the Islamic banks because of the special nature of the Islamic banks that completely differ from that of the conventional banks.

Therefore, the main objective of this thesis is to explore the role, functions and the necessity for establishing Islamic central banks in Muslim countries to substitute conventional central banks and play their role in supervising and controlling the Islamic banks.

The first chapter presents the general framework of the study. It also discusses the objectives and the importance of Islamic central banks for Islamic banks and monetary agencies. Chapter two discusses the elements of the banking system. It focuses on commercial banks, specialised banks and the central banks. It also discusses the Islamic banks, their origin and development, providing their definitions, characteristics and features.

Chapter three explains the reasons for setting up Islamic central bank, its definition, characteristics and the economic objective. It also discusses banking interest and usury, its definition and its kinds. This chapter also describes the credit facilities in Islamic banks.

The functions and role of Islamic central banks are analysed in chapter four.

Chapter five describes in detail the quantitative and qualitative credit control instruments adopted by Islamic central banks, in addition to the direct and the Islamic control tools.

Chapter six analyses the banking control on Islamic banks in some Islamic countries. The final chapter summarises the findings and recommendations of the thesis which confirmed the possibility of establishing an Islamic central bank with its independent role, functions and techniques which enable it to efficiently supervise and monitor the Islamic banks.

ACKNOWLEDGEMENT

Praises and thanks be to Allah, for He guided me to success in the choice of this subject, assisted me in delving into it and finishing it. He directed those of His good people to lend me support, having followed up my work and supervised it until it saw the light of the day. May prayers, blessings and peace be on His honest Prophet and Messenger.

My deepest appreciation and profuse thanks go to Professor D.P. Davies for supervising my research, for his encouragement, insightful suggestions, guidance and constant queries about the progress of the research work. I also extend my sincerest thanks to Dr. Mohamed Mashuq Ally for supervising this research work for some years, and for giving me the opportunity to pursue my studies. His constant encouragement, continuous follow-ups and enlightening remarks stood me in good stead.

It is also my duty to record here my appreciation, thanks and extreme gratitude to Professor Mahmoud Assaf for many of his favours. As a keen observer, helpful manager and, he gave me the opportunity to continue my scientific quest.

I am also grateful to Dr. Bassam Saee of Oxford Academy, Dr. Abd Assattar Abu Ghudeh, Dr. Mohammed El Qari Bin Aid, Dr. Fouad Shaker for their illuminating discussions and encouragement.

Thanks are also due to the management of Al Baraka Group, Centre for Research and Training in Islamic Development Bank, Centre for Research in Islamic Economics (Jeddah), International Union for Islamic Banks, General Council for Islamic Banks and Financial Institutions, Saudi Arabian Monetary Agency, Central Bank of Kuwait, Central Bank of Egypt, Central Bank of Malaysia, Central Bank of Iran, State Bank of Pakistan, who answered my queries and provided me with the helpful material and data.

I must not miss out mentioning my gratitude and appreciation to all those who have assisted me and directed me, to those who followed up my work and those who gave me pieces of advice during the research work.

Lastly, I cannot and shall not forget my duty of addressing my greatest thanks and gratitude to my parents who raised me, supported me, and motivated me to strive for the highest level of achievement. This research work is one of the fruits of their encouragement and guidance.

Thanks and appreciation to my wife, my dear sons, Hashim and Assem, and my daughter Rawan for their encouragement and patience.

May our last prayers be in praise and thanks to Allah, the Lord of all worlds.

TABLE OF CONTENTS

CHAPTER Page

CHAPTER Page

CHAPTER Page

CHAPTER Page

LIST OF ILLUSTRATIONS

TRANSLITERATION	TRANSLATION
Shariah, Islamic shariah	Islamic Law, Islamic legislation
Quran	The revealed Scripture (The Holy Quran)
Sunnah, Prophet' sunnah	Prophetic action and traditions
Hadith	Prophetic tradition, Prophetic saying
Fiqih, Fuqaha	Jurist, Jurists
Madhhab (pl. Madahib)	School(s)of jurisprudence
Fatwa (pl. Fatawa)	Islamic legal opinion (s)
Halal	Permissible, Lawful
Haram	Prohibited
Aslamah Islamisation, Islamising	To be accepted in Islam
Riba	Usury, Interest
Riba Al-Fadl (tafadul)	Increase usury
Riba Al_Nasi'ah	Deferred payment usury (time delay)
'Ayn,	Possession, non-fungible
Dayen	Debt, liability
Bay'e, Beyou'e	Sale
Thaman	Price
qimah	Value
Sarif, Sirafah	Exchange
Masref	Bank
Tawliyah	Sale at cost
Wadi'a	Sale at a loss
Hiwalah	Bill of exchange
Sifatege'a	Bill of exchange, Transfer of liability

TRANSLITERATION	TRANSLATION
Murabaha	Cost-plus sale
Salam	Forward sale
Istisna'a	Manufacturing
Mudarabah	Speculation
Musharakah	Partnership
Ijarah	Leasing
Jialah, Jo'alah	Promise of reward
Muzara'a	Crop sharing
Mugharasah	Plant tress partnership
Musaqah	Land watering partnership
Qard Hassan	Interest-free loan
Zakah	Alms
Sahih	Valid
Bay	Sale
Hibah	Gift
Ida'e, Wadi'ah	Deposit
Wakil, Wakalah	Agent, Agency
Rahn	Pawning
Daman	Guaranty
Amanah	Trust
Jahalah	Ignorance
Gharar	Uncertainty

LIST OF TABLES

CHAPTER 1

GENERAL FRAMEWORK OF THE RESEARCH

INTRODUCTION:

Today banks are a must. Banking system has a long history. In fact, a primitive form of banking process was practiced by many early societies. They gradually developed with the passage of time.

The presence of money-exchangers in early societies has been historically proved. They used to perform most banking operations. Banking practice resulted from the need to facilitate commercial exchange, save, invest and disburse money.[1] Many ancient civilizations like the Sumerians, the Greeks and the Romans were known for this. Ancient documents prove that the Babylonians were highly advanced in the credit field.[2] The law of Hammurabi[3] which goes back to the eighth century B.C. contains several provisions which regulate and govern the deposits and borrowing at interests.[4] As for the Greeks, the banking activities started when the temples undertook the practice of banking business. Banking activities were also practiced in the public and private companies which accepted deposits, granted loans, exchanged currencies, and effected transfers between the cities. Then came the Romans, who learned the art of banking business from the Greeks. It was the Romans who expanded the banking business in the geographical

---

1 Holdsworth, William, *A History of English Law*, London (UK): Sweet & Maxwell Ltd., Vol. 8, 1937, p.177.

2 Hammoud, Sami, *Tatweer Al Aamal Al Masrafiyah bima yatafiq wa Al Sharia Al Islamiyah (Development of Banking Operations in Agreement with the Islamic Shariah)*, Amman (Jordan): Al-Sharq Press, 1982 [2nd edition], pp 36-43.

3 Hammurabi, the king of Babylonia, was the greatest ruler in the first Babylonian dynasty. He was a successful military leader and administrator. Hammurabi is primarily remembered for his codification of the laws governing Babylonian life.

4 El-Nouri, Hussein, *Bohoth Qanoniyah Fi Al Benouk (Legal research in Banking)*, Cairo (Egypt): Ain-Shams Library, 1974, p.9.

locations which they controlled and governed, as well as in the neighboring regions.[1]

From the foregoing we can infer that the ancient civilizations practiced some banking operations in a limited way. With whatever potential and means available at those times, the banking operations served the business of their individuals, facilitated the trading exchange and saved funds from theft or loss. These practices were passed down from one civilization to another, undergoing changes in the process. Yet they stayed primitive without achieving efficiency in attracting funds or in saving or investing them. However, this was considered a successful start and an important foundation on which the banking activities that were built thereupon developed later in a modern and more developed form.

The modern banks owe their origin to some institutions which prevailed in Europe in the Middle Ages. At that time, European traders, usurers and jewelers - especially in Venice, Genoa and Barcelona - used to accept deposits to save them against loss or theft. Against these deposits, they issued the owners deposit nominal certificates. Banking activity remained connected with commercial business. Since traders were the first to start this activity, the banking operations bloomed with the bloom of trade and declined consequential to its decline. That is why the banking activity expanded following commercial bloom witnessed by European countries such as Italy, Spain and Holland, until matters settled down in England. This was due to the Lombardian traders who came over to England from the Italian cities in the 14th century A.D. in quest of the commercial activity witnessed by England at that time.[2] As a result of

1 Hammoud, Sami, *Tatweer Al Aamal Al Masrafiyah Bima Yatafiq Wa Al Shariya Al Islamiyah (Development of Banking Operations in Agreement with Islamic Legislation)*, op. cit., p.38.

2 Antaqui, Rizkallah, & Siba'i, Nehad, *Al-Waseet Fi Al Houkok Al Tejariyah Al Bariyah (Al Waseet in land Commercial Rights)*, Damascus (Syria): Al-Ta'awuniyya Press, Vol. 2, 1964, p.11.

the arrival of the Lombardian emigrants, an important part of banking business developed. This could, therefore, be considered the modern beginning of the application and implementation of the idea of the letter of credit.[1]

Reference books point out that the first government bank was set up in the city of Venice under the name of Banco della Piazza di Rialto in the year 1157.[2] Several other European cities followed suit. A deposit bank was established in the Spanish city of Barcelona in the year 1401 as well as the Dutch Amsterdam Bank in the year 1609.[3] The Amsterdam Bank is considered to have been the model bank for many European banks established after that despite the diversity in conditions and circumstances between the countries. The basic and fundamental purpose of the Amsterdam Bank was to hold deposits and transfer them, at request, from one account into another, to deal in currencies and to offset drafts.[4]

Afterwards, as a result of the Industrial Revolution and the growth of companies in Europe, there was a need for large banks to undertake the financing of these companies and lending them required funds. This led to the establishment of many of these banks. They grew and expanded their operations, opening branches in many more places.

In general, it could be said that the basic and fundamental functions of the banking systems in the European countries were affected by the different stages of economic development in these countries. Therefore, banking operations expanded and diversified in countries which witnessed industrial and commercial boom, until they reached

---

1 Parker, J.B., *Banking*, London (UK): The English University Press, 1961, p.16.

2 Mare'i, Abdel Aziz, & Ibrahim, Issa Abdo, *Al Noqoud Wa Al Benouk (Money and Banking)*, Cairo (Egypt): Lajnet El-Bayan El-Arabi Press, 1962 [1st edition], p.193.

3 Ushert, Abott Payson, *The Early History of Deposit Banking in Mediterranean Europe*, Cambridge (UK): Harvard University Press, Vol. 1, 1943, p.24.

4 *Encyclopedia Britannic*, History of Banking, Vol.4, p.93.

an advanced stage of progress and organisation. Then, they spread out to the remaining countries.

With the advent of the 21^{st} century, banks grew in importance so much so that today not a single country stands without having a group of banks.

Then the idea of the Islamic banks was floated. Supported and developed by many Islamic countries and societies, they became a major part of the banking system and organization in many Islamic countries. Since these banks and financial institutions need the control of a supervisory body, it was felt to have a specific authority which would control the activities of these institutions, companies and banks to ensure the viability of their operations and to direct them towards the right direction laid down by the leadership of the State, to protect both investors and depositors, and to uphold the strength of the economy. That was the bell that rang the announcement of the birth of central banks.

1.1 THE SUBJECT OF THE STUDY:

Banking business and operations have expanded in most countries of the world. Banks have become one of the most important pillars of the economy of any country and the axis of its success. The practice of modern banking operations has moved over from Europe.

These banking activities made entry into the Islamic World too. As a result, clients were divided into three categories[1]:

A) Those who decided to stay away from such organisations for fear of the prohibited usury.

B) Those who decided to confine their dealings to drawing benefit from some of the approved services.

---

1 Khan, M. S., & Mirakhor, A., *The financial system and monetary policy in an Islamic Economy*, Jeddah (Saudi Arabia): A research published in journal of Center for Islamic Economics, King Abdul Aziz University, Vol. 3, 1991, p.85.

C) Those who decided to deal with them and all their activities without caring for what is lawful or prohibited.

Many Islamic countries have surrendered to the practice of banking activities despite their dealings in usury. As a result, a group of Muslim economists dedicated itself to design a monetary and banking system which is free of interest. Their efforts resulted in popularising the idea of Islamic banks in several countries, and in making them practice Islamic banking activities free of prohibited usury. During the last 30 years, a number of Islamic banks, financing institutions and investment organisations have been established in several Islamic countries. Today there are more than 201 Islamic banks and financial organizations operating in various countries.[1] The success of Islamic banking led a number of traditional banks to open branches for Islamic transactions and dealings[2].

The gist of the practical application of most of these Islamic banks and institutions proved that they had huge success and were in demand. These Islamic financial banks and organisations became the focus of interest of the observers on international money and business markets due to

---

1 Source: *Islamic Finance Directory,* Published by General Council for Islamic and Finance Institutions, Manama (Bahrain), 2004, p.4.

2 Here is information on some conventional banks which announced the setting up of branches for Islamic banking transactions:-

* City Bank: An article in Al Sharq Al Awsat newspaper (Middle East Review) dated 19/4/1995 p. 11, said City Bank is to set up an Islamic Bank in Bahrain.
* Some Italian banks including "Banco di Roma ", "Banco di Napoli", "San Paolo di Corneoll, "Banca Lariana", "Banco di Credito Presciano" (agricultural bank). An article in Al Sharq Al Awsat newspaper (Middle East Review), dated 20/1/1994 p. 16.
* The Philippini Islamic Investment Bank: An article in Al Sharq Al Awsat (Middle East Review) dated 1/2/1997 p. 14, said: "Philippines to finish soon the preparation of the working statutes of Islamic banks."
* City Bank has established an Islamic bank in Bahrain, says a report in Al Sharq Al Awssat newspaper, issued in London, dated 22-09-1996, p 17.- And, see the details contact information for Citiislamic Investment Bank in Arab banking and Financing Directory, published by Tele-Gulf Directory publications, Manama (Bahrain), 2004, p.98.

their expansion and growth, and due to their system different from those of the conventional banks and organisations.

International and European organisations showed keen interest in learning more about Islamic banking. The World Bank and the International Monetary Fund as well as a number of European and American institutes arranged seminars and meetings, prepared field studies, and conducted scouting visits to Islamic banks and financing organisations.[1]

However, the applied practice of the Islamic banking activities revealed loopholes and stumbling-blocks which hindered their speedy launch, and which restricted their activity. The reason for the obstacles was not due to Islamic banking system itself, but due to the environment in which they operated and the systems which governed them. This spurred Moslem economists to find efficient and useful remedy for the loopholes. One of the most important obstacles which intercepted the work of the Islamic banks and financial institutions was the issue of their dealing with the central bank and their relationship with it. Central banks in most Islamic countries are still conventional, having no knowledge or experience about the works and activities of Islamic banks. As a result, Islamic banks found themselves facing two problems:

A) That they may not contravene the main features which govern their operations.[2]

B) That they cannot contravene the conventional banking regulations and restrictions, criteria and methods which were laid down by Central Banks and monetary authorities.

---

1 An article in the Al Sharq Al Wassat Newspaper dated 19/4/1995, p.12, under the title: "The American Harvard University teaches, for the first time, the bases of Islamic banking".

2 The main features of Islamic banks are reported in the chapter 2 page 40 of this thesis.

Therefore a legitimate substitute for the conventional central Bank became a necessity. A substitute that would perform central bank's role and undertake its functions but on condition that its role, functions, tasks, relationships and all of its methods would be legally acceptable and not conflict with the Islamic Shariah. Several efforts were made to solve this problem and to bring closer the viewpoints of Islamic banks and those overseers of the central banks. Some organisations such as the Organisation of the Islamic Conference (OIC), the International Union of Islamic Banks, the boards of governors of central banks and monetary authorities arranged meetings to exchange ideas and conduct deliberations. The meetings resulted in the constitution of joint committees of experts, representing Islamic banks and central banks. Tasked with finding adequate contexts related to the connection between the central banks and the Islamic banks in such a way as to achieve the objectives of the former without conflicting with the features and characteristics of the latter.[1]

That is why I felt that the subject of my thesis would be: The Role of the Central Bank in an Islamic Banking System. Here I would review the conventional and traditional system of central banking as applied at present in many countries. Then I would look into the possibility of setting up a system of Islamic central bank having functions, relationships, methods and practices that would agree with the provisions of the Islamic Shariah, and which would perform the same functions and tasks undertaken by the conventional central bank.

---

1 International Union for Islamic banks, *Solving the conflict between Islamic banks and central banks*, Cairo (Egypt): International Union of Islamic banks, 1987, p.6. A report presented to the International Union for Islamic banks about the results of the meeting that was held in Jeddah (Saudi Arabia) in May 1987 for the joint committees between the representatives of the Islamic banks and the governors of the Central Banks for some Islamic countries. This report has included a list of the obstacles that faces the Islamic Banks with their relations with the central banks and suggested solutions for these obstacles.

The reason for selecting this subject is the importance of the central bank in the banking system of any country and the fundamental role played by it as well as the mark it leaves on national economy when practicing its authorities and when drafting and implementing the monetary policy of a country.

Accordingly, I sum up the motives which made me select this subject:

1. That Islamic banks have expanded and have achieved substantial growth which attracted interest.
2. That most of these Islamic banks operate within conventional and traditional banking systems, and are subject to the banking control and supervision of a conventional and traditional central bank.
3. That several of the methods and instruments of the current conventional central banks which they use cannot be applied under an Islamic economic system, in view of their conflict with the Islamic Shariah.
4. That many Islamic countries wish to set up Islamic banking entities with all their constituents, systems and policies. That is why my present subject may be of service to these programmes.
5. Through research on Islamic central banking system it is possible to develop new Islamic monetary and banking systems which would be substitutes for conventional and traditional systems, taking into consideration the distinctive nature of the Islamic banks.
6. That by virtue of its functions, tasks and duties, the central bank has an important role in the economic life of any country, which can neither be ignored nor neglected. That is why it is a must to dedicate the potentials of the central bank and its energies in the Islamic economic system in such a way as would serve this aim, and achieve that purpose.

1.2 STATEMENT OF THE PROBLEM:

The basic and fundamental problem, which is subject of the study in this research work, is that the conventional central banks are not legitimately acceptable under an Islamic economic system as their basic reliance is on instruments and methods prohibited under the Islamic Shariah. Therefore, it is impossible to use the same conventional instruments and methods of the central bank in control and supervision of Islamic banks in view of the special circumstances, and conditions and distinctive nature of the Islamic banks.

Accordingly, this problem has two fundamental and basic dimensions with a certain contradiction and difference. The contradiction and difference is the origin of our present problem. These two dimensions are:

A) A conventional banking system formulated with restrictions, criteria and methods derived from traditional and conventional systems and laws fixing the relationships of the central banks with the government and the other banks as well as with the remaining entities. This system was imported by most Islamic countries from its origin in western countries.

B) The existence of Islamic banks having distinctive nature and characteristics is conflicting in some of its facets to the basics and fundamentals of the established conventional banking system.

In practical application, the methods and instruments adopted by the conventional central banks in supervising Islamic banks exposed a lack of coordination because of the special and distinctive nature of the Islamic banks. Furthermore, it was evident to us that many of the operations between the central banks and the government cannot be accepted under an Islamic economic system. These are the financing and funding operations of the government, lending and the management of its funds and assets by the central bank, and even its relationships and negotiations with other countries on its behalf. Moreover, the methods and ways used by the central bank in laying down and implementing the monetary and economic policy are mostly based on foundations which do not agree with the doctrines of the Islamic Shariah. Some of the quantitative and qualitative instruments central banks use in the control of credit like the discount rate, the interest rate and the open market operations contradict the Islamic Shariah.

On the basis of the foregoing, it ensues that the problem stems from the contradiction and difference between the requirements, activities and functions of the conventional central banks and the doctrines of the Islamic Shariah, which is the basis of the Islamic economic system.

Efforts were made by experts to solve this contradiction and difference. These efforts achieved positive results in some countries. However, the problem remains, though its intensity varies from country to country. Therefore, it was inevitable to look for a substitute to the conventional central banks. This substitute would be a Islamic central banking system which would take into consideration the characteristics and distinctive nature of the Islamic banks.

1.3 THE HYPOTHESES OF THE STUDY:

There are several facets of difference between Islamic and conventional banks, whether as to their nature or their activities or their characteristics. Since the recent conventional central banks have derived rules and regulations from the conventional banking system, it is expected that some of the practices and functions of the conventional central bank would not fit suit the Islamic banking system. It would be impossible for Islamic banks to be subjected to the control and supervision of conventional central banks.

Accordingly, this study is based on the following hypotheses:

1. That some functions, methods and systems of the present conventional central bank would not suit the nature of Islamic banks. In many cases, it would conflict with the nature of the Islamic banking system. However, some parts may suit the Islamic banks after amendments,

2. That through the Islamic economic system which emerges from the doctrines of the tolerant Islamic Shariah, we can form a general framework of the Islamic central bank. Its functions, methods, systems and restrictions would be determined so that it would be a substitute for the conventional central bank, performing its role, while following the doctrines and teachings of the Islamic Shariah.

1.4 THE OBJECTIVES OF THE STUDY:

The objective of this research work is to study and analyse the elements and constituents of the conventional central banking system, and to determine the adequacy of the elements with the nature and the characteristics of the Islamic banks and the Islamic economic system to formulate an Islamic central banking system which would be acceptable in Islamic societies and which would be capable of practicing the required economic and monetary role. In order to reach those goals and objectives, the following must be done:

1- The analysis of the functions of the conventional central bank, its relationships and methods, together with the evaluation and assessment of those functions and methods with the nature and characteristics of the Islamic banking system.

2- The development of the functions of the conventional central bank, and its present instruments, together with amendments introduced thereto, and exchange some of them to make them suitable for the Islamic banking system and the Islamic banks.

Therefore, the study of this subject has a special importance for the following reasons:

A) That creating a central Islamic banking system enables the central bank to play its supervisory role over the Islamic banks efficiently and effectively, through ordaining those systems and laws which would suit their nature and would cope with their characteristics while not conflicting with their bases of foundation.

B) That the existence of Islamic central bank would represent a response to the requirements of Islamic banks, and an understanding of their circumstances and characteristics, thus answering their requisites, and enabling them of performing their work and of practicing their activity in such a way as would suit their nature and features.

1.5 THE DIFFICULTIES OF THE STUDY:

The researcher faced several difficulties while conducting his research work. These difficulties are as follows:

1- The lack of response from part of those in charge of central banks in several Islamic countries to the correspondence and the queries which the researcher sent them, with the exception of Egypt, Qatar, Iran, Pakistan, Kuwait and Malaysia, in addition to Saudi Arabia.

2- The scarcity of reference books which deal with this subject. Despite the many reference books which tackle the subject of Islamic economy and Islamic banks, the reference books which deal with Islamic central banking and its rules were relatively few which dictated it upon the researcher to make more effort and undergo more toil in quest of the piece of information.

3- Many staff members in central banks and those in charge of them in many of the Islamic countries ignore the nature and features of Islamic banks, and the investment and financing methods therein, due to their experience and field of work being confined to the systems of conventional banks. This added up to the researcher's suffering in the absence of any benefit being drawn out from dialogue and discussion with them.

4- That many of the scholars of Islamic legislation met by the researcher, whose opinion could have been made use of (despite their abundant knowledge in the field of Islamic legislation), were unaware of the functions of the central bank, its characteristics and instruments, as well as its policies and nature of operations, as a result of which they could not be of use to this effect.

5- That conducting research work on the Islamic central banking system dictated it upon the researcher to refer to original jurisprudence books, to biographies of the Prophet and to books of the Prophet's sayings (most of which are in Arabic) to quote from them. When translating these paragraphs, which are strongly inter-connected, of precise meanings and of coordinated structure into English, the core of the meaning was transferred but the strength of the text remained amiss.

1.6 THE METHODOLOGY OF THE STUDY:

The study of the subject of the role of the central bank under the Islamic banking system dictates it upon us to tackle the present tasks, functions and activities of the conventional central bank, then analyse those functions, tasks and activities, preclusive of adopting functions, tasks and methods which would suit the nature of the Islamic economic system, without conflicting with the Islamic Shariah. The researcher cannot adapt Islamic functions and methods for the central bank, except after having reviewed the functions and methods used by the conventional central banks, then incorporate them into their study and analysis, and consequently submit them to the balance of Islamic Shariah to identify the contradictions, then try to adapt a general framework for the Islamic central bank wherein its functions, tasks, methods and activities would be determined. Therefore, our research of this subject takes place through three basic sides:

1- The review of the conventional central banking system as applied at present in several countries through, and to identify the tasks, functions and activities of the conventional central bank, and all its methods and means which it uses, in addition to all its relationships with each one of the other banks and with the government.

2- The analysis of those functions, activities and relationships, and review them on the basis of Islamic Shariah to indicate the standpoint of Islamic jurisprudence in relation to them.

3- An attempt to arrive at a general framework of the Islamic central bank which would agree, in its functions, relationships and activities with the provisions of the Islamic Shariah.

And until full coverage of the said three factors, the researcher reviewed reference books, reports and systems which dealt with the subject of banking activities in general and with that of the central banks in particular, and has followed up some conferences which were held to discuss the subjects connected with that of this research work. Therefore, the researcher used in this research the analytical descriptive methodology, in addition to the deductive one, both of which are the most suitable methodology for the subject of this research work which is set up on an attempt to find a framework for the Islamic central bank system. The researcher relied on the analytical descriptive approach in some chapters, while using the deductive approach in some others. In some chapters, he mixed the use of both approaches.

The researcher found out that the other research methodologies are less suitable to the subject of this research work. For example, he found out that the experimental approach does not agree with the nature of this subject as the research work deals with a social phenomenon affected by several variations and elements. Similarly, the quantitative approach application requires that there should be a stable and applicable system as a result of which the methodical approach would measure the quantitative effects of this system. These constituents are not available in the problem subject of this research work. We are attempting to formulate a new Islamic banking system. In this case neither the formulation nor the application took place in such a way that we could measure the effects quantitatively.
The study has used two main research approaches:

A) The desk-research through reference books, periodicals and the reports connected with the issues. This is in addition to contacts in writing with a number of Islamic research centres, Islamic banks and financial institutions and central banks to obtain information.

B) The interview approach through which the researcher conducted a number of interviews with officials in charge of Islamic banks, financial institutions and central banks.

1.7 THE SCOPE OF THE STUDY:

The general framework of this research work contains seven basic chapters:

In the first chapter, the researcher exhibits the general framework of his study. He introduces the research work, describing the origin and development of banks. The research then states the problem of the research work, its hypotheses, and its objectives as well as the importance of the study. It also mentions the difficulties faced by the researcher, the approach adopted in the study, and the plan of the study.

The researcher devotes Chapter 2 to the discussion of the elements of the banking system. So, this chapter consists of two main parts: the first is allocated to the clarification of the definitions of the bank, and the second is devoted to the elements of the banking system. There are four subsidiary divisions. The issue of commercial banks and its definitions is in the first division, while specialised banks and it types are explained in the second division. The third division is devoted to the subject of central banks, and the review of their origin and development over the years, their definitions and main functions. The fourth division discusses the Islamic banks, their origin and development, together with their definitions, characteristics and features.

Since the subject of this research work is about the role of the central bank in an Islamic banking system, therefore Chapter 3 is devoted to the indication for the justifications for establishing an Islamic central bank which agrees in its activities and functions with the Islamic Shariah. Thus, this chapter consists of seven major parts. The first is devoted to the operational environment of the present Islamic banks. We explain in this part the relationship between the Islamic banks and the central banks, and show the three specimens under which Islamic banks operate. Then we move to the second part that consists of the most important reasons and justifications which dictate and necessitate the setting up of an Islamic central bank. The third part of this chapter is devoted to finding out a definition of the Islamic central bank, determining its advantages and characteristics which distinguish it from conventional central banks.

The forth part is about the characteristics of Islamic central bank. While in the fifth part, the economic objectives of the Islamic central bank are described. We shed light on the role of the Islamic central bank in achieving the balance economic and social development, and the justice in distribution of income and wealth, in addition to achievement of the highest level of employment.

The banking interest is the main reason that renders most banking operations on the conventional planes inclusive of the operations of the central bank, prohibited and unacceptable under the Islamic Shariah. Therefore, we tackle in the sixth part of this chapter, the subject of banking interests and their relationship with usury, and the kinds of usury prohibited by Islam. The seventh and the last part of this chapter is concentrated on the credit facilities in Islamic banks. It consists of five divisions. Each division is specified for a certain mode of Islamic credit facility.

The study moves on, afterwards, to the analysis of the functions of the conventional central bank in order to extract new functions for the central bank which would be acceptable under the Islamic economic system. That is why chapter four of our present study is dedicated to determining and analysing the functions of the central bank under the Islamic economic system.

This chapter consists of five basic and fundamental parts. Each part is allocated to reviewing an independent function of the Islamic central bank supported by both explanation and analysis. As for the first part, it is devoted to dealing with the subject of money printing and its management and organisation. We clarify the definition of money from Islamic perspective. We also define how money is issued and minted in the Islamic countries, with some legislative provisions.

The second part is dedicated to the discussion of the subject of the relationship of the Islamic central bank with the government. We clarify the tasks performed by the Islamic central bank on behalf of the government, and its role in funding and lending the government.

The third part is dedicated to the exposition of the function of the Islamic central bank which is interested in organising its relationship with other operating banks within the scope and boundaries of the country.

The role of the Islamic central bank in achieving economic and social development in a Islamic country is the subject of part four of this chapter.

Part five is dedicated to the function of the Islamic central bank and its role in the controlling directing credit.

In view of the importance of the operation of eventuating credit as to the economic life of any country, the researcher has dedicated chapter five of this study to the explanation of the modus operandi or mechanics of credit, together with the methods and ways used by the Islamic central bank in as far as the orientation of the credit policy of the country is concerned. Therefore, this chapter consists of three main parts: the first is devoted to the discussion of the methods of the Islamic central bank in relation to the quantitative control of credit, the second part tackles the subject of the qualitative instruments used by the central bank in the control and orientation of credit, and part three is independently dedicated to reviewing the most important direct methods used by the central bank in relation to the control and orientation of credit.

In the sixth chapter, the researcher states the patterns of control systems on Islamic banks in some Islamic countries. This chapter consists of four main parts. Each part is designated to the review the role of the central bank in the field of controlling the Islamic banks in one of the Islamic countries. The first part explains the controlling role of the central bank of Sudan on Islamic banks. The second part is for the bank control in Iran with an explanation to the Islamic banking law there. The third part is dedicated to describing the role of the Central Bank of Pakistan in controlling the banking system and monitoring the monetary policy of the country. The last part is to show the banking system in Saudi Arabia and the role of the monetary agency in controlling the banks and monitoring the credit thereafter, together with a revision to the Islamic banks operating in the Saudi market.

The researcher ends his study with chapter seven with important results and recommendations of this research work.

CHAPTER 2

THE ELEMENTS OF THE BANKING SYSTEM

INTRODUCTION

THE banking system in any society consists of several institutions, performing various banking tasks. Therefore, these institutions have a great influence on the economic and social lives. Since borrowing and lending is the main banking business, these are considered the most important source of funding and financing in the national economy of any society.[1]

The banking system consists of mainly three types of banks. These types are commercial banks, specialized banks, besides the central bank. Lately, another sort of banks has come into operation. They are the Islamic banks. These banks differ from the commercial and specialized banks in several aspects, the most important of which is that they do not deal in interest. They seek out fields of investment in line with the provisions and goals of Islamic regulation.[2]

The activity and elements of the banking system vary from one country to another, because of the difference in the economic systems. Therefore, in this chapter, the researcher will shed light on the elements of the banking system, the different units forming the banking system, and the position of the central bank thereof.

2.1 DEFINITION OF BANK:

The word 'bank' is derived from the Italian word banco, meaning the table or the bench. This is due to the fact that this word, in banking operations, has been connected with

---

[1] Borai, Mohamed Khalil, *Al Noqoud Wa Al Benouk (Money and Banking)*, Cairo (Egypt): Nahdat El Shark Press, 1985, p.75. See also: Ramadan, Zeyad, *Edarat Al Aamal Al Masrafiyah, (Management of Banking Operations)*, Amman (Jordan): Printed under the sponsorship of the Jordanian University, 1977, p.5.

[2] For more details about the main differences between Islamic banks and conventional banks, please see page 45 of this research.

the habit of the Italian money-exchangers at the end of the Middle Ages whom they used wooden desks to carry out their business.[1] The Arabicised version of the word bank is masrif, which is derived from the Arabic word Al-Sarf. And Al-sarf means selling cash for cash.[2] It is noted in Al Mujaam Al Waseet,[3] that the bank is the place where money can be exchanged, and for this reason the bank is called Masrif.[4] In Majalat Al Ahkam Al Adliyah[5], exchange or Sarf has been defined as the sale of 'cash for cash'.[6] Some others define the word bank as being the place where money transactions take place on demand. This means that banks operate as an accumulator of funds, made by depositors, and lends them to individuals. Therefore, they act as an intermediary between depositors and investors.[7]

From the above we come to know that the bank or Al-Masrif is the place where disbursement or exchange takes place.

---

1 Gilbert, J. W., *The History, Principles and Practice of Banking*, London (U.K.): G. Beil & Sons Ltd., Vol.1, 1992, p.9.

2 Mostafa, Ibraheem, & others, *Al Mujaam Al Waseet, (Intermediate dictionary)*, edited by Arabic Language Assembly in Cairo, Istanbul (Turkey): published by Dar Al Dawah, Vol.2, 1989, p.513.

3 Al Mujjam Al Waseet is Arabic to Arabic dictionary, it is edited and prepared by selected members from the Assembly of Arabic Language in Cairo, Egypt. It is considered an important reference in the Arabic language.

4 Ibid, p. 513.

5 Majallat Al Ahkam Al Adliyah is a book that consists of juristic transactions, litigation matters, and regulations according to Hanafi creed. This book was written in Shaban 1293 Hegira when the Ottoman Caliphate decided to set up a panel of scholars and jurists in the field of Islamic jurisprudence to prepare a book, detailing juristic regulations and even the most common transactions. The panel prepared this book and collected the juristic regulations which contain 99 principles divided into 1851 items. (Source: Qari, Ahmed A., *Majalat Al Ahkam Al Shareyah*, Riyadh (Saudi Arabia): Tihama publishing, 1981 [1st. edition], pp.27-32.

6 Ali, Haydar, *Dorar Al-Hokkam, Shareh Mejallat Al-Ahkam*, Beirut (Lebanon): El-Nahda Library, 1969, p.98.

7 Ramadan, Ziyad, *Edarat Al Aamal Al Masrafiyah*, op. cit., p.5.

2.2 THE ELEMENTS OF THE BANKING SYSTEM:

There are three types of banks, these types are commercial banks, specialized banks and the central bank. In some countries Islamic banks have been an addition to the banking system.

2.2.1 COMMERCIAL BANKS:

Commercial banks have been defined in several ways. It must be clarified that the term 'commercial' is only idiomatic. It gives the impression that these institutions only deal with traders. The fact, however, is that the commercial banks give loans not only to traders, but to anyone who provides guarantee and security.[1] Commercial bank has been described as being 'the organization which undertakes the mediation role between depositors and borrowers, and which also eventuate credit'[2]. Others define the commercial bank as being 'one of the specialized economic establishments confined to dealing in money, providing an efficient system for the deposits and savings. It also takes responsibility for settling all transactions between business establishments and individuals, in addition to proving the necessary funding or financing'[3]. So, commercial bank is an important and effective element in the banking system. It provides liquidity to investors.

2.2.2 SPECIALIZED BANKS:

There are some specialized operations whose funding or financing requires special expertise and a deep knowledge of the nature of the market. For instance, if we take the

---

1 El-Masri, Samir Hussein, & Hussein, Salah, *Eqtisadiyat Al noqoud wa Al bonouk (Economy of Money and Banking)*, Jeddah (Saudi Arabia): Dar Okaz Printing and Publishing House, 1980[1st edition], p.101.

2 Shafie, Mohammed Zaki, *Mokadima Fi Al Nokoud Wa Al Bunouk (Introduction to money and banking)*, Beirut (Lebanon): Dar Al Nahdah Al Arabiya, 1952, p.190.

3 Al-Horani, Ahmad, *Mohadarat Fi Al Nuzum Al Naqdiyah wa Al Masrafiyah (Lectures on the Monetary and Banking Systems)*, Amman (Jordan): Dar Majdalawi for Publishing and Distribution, 1983, pp.37-38.

financing of agricultural activity, we find that although it does not frequently need a long-term financing, but it still requires special administrative and the financial arrangements for its village branches.[1] Financing here is related to a different sort of guarantee or security. Guarantee here is on agricultural crops or on the land, as against the guarantee or security required by the commercial banks.[2] This brings specialized banks into play which provides long-term and medium-term credit for the funding and financing of such sectors. These specialized banks have been defined by economists as those which finance economic, industrial, agricultural or real estate projects, according to their field of specialization.[3] Others define specialized banks as those whose main task is the real estate, agricultural or industrial financing, with deposits at call not being part of their activity. They are named according to their specialization, such as the Real Estate Bank and the Agricultural Bank.[4]

It is to be noted here that the second definition is the most comprehensive one, as it has excluded some banking operations not conducted by specialized banks.

2.2.3 CENTRAL BANKS:

The central bank is occupies an important position in the money market. It controls cash and credit, and implements the monitory policy. It, therefore, monitors various banks and coordinates their business activities. Most central banks all over the world perform more or less the same task. With concern to their objectives and functions, the central banks are differs from the rest of the other banks, as the

---

[1] Bora'I, Mohamed Khalil, *Al Noqoud Wa Al Bonouk (Money and Banks)*, op. cit., p.140.

[2] Al-Jammal, Ghareeb, *Al Masaref Wa Biuet Al Tamweel Al Islamiyah (Banks and Financing Houses)*, op. cit., p.30.

[3] Al-Horani, Ahmad, *Mohadarat Fi Al Nuzum Al Naqdiyah wa Al Masrafiyah (Lectures on the Monetary and Banking Systems)*, op. cit., p.44.

[4] Al-Jammal, Ghareeb, *Al Masaref Wa Biuet Al Tamweel Al Islamiyah (Banks and Financing Houses)*, op. cit., p.30.

main purpose of any central banks is the supervision and control over the operation of other banks and to organize the banking activities in the country.

The central bank must have a set of authorities to control the banks under its purview. At the same time, it must itself be subjected to the general policy of the country.

(1) THE ORIGIN AND DEVELOPMENT OF CENTRAL BANKS:

Central banks came into picture long time after the commercial banks. There was no clear concept of central banking prior to the beginning of the 20th century. For, in several countries, there was only one bank which monopolized the largest part of the right to issue banknotes or money notes, working as the bank of the government and its agent, without these being called central banks. The main function of these banks was the organization of money issue according to the rules and regulation laid down by the country, and to maintain the convertibility of the money notes into gold or silver or both. With the passing of time, these banks were given more duties and authorities, until the term, central bank, became popular and gained a standardized definition and purpose. The Swedish central bank, (Risk Bank), is one of the oldest central banks established under this concept. This bank was the offshoot of a private bank founded in 1656. It was reorganized as a state bank in 1668. It then developed gradually, until it became a central bank.[1]

Many researchers, however, refer the date of the foundation of central banks to that of the establishment of the Bank of England in 1694. It was established by public subscription for one clear and overt purpose, which was that of lending money to the government, against granting it the concession right of issuing the money notes by means of the provisions of a law ratified by parliament. This privilege was subject

---

[1] De Kock,M.H.G., *Central Banking*. Translated by Abdel Wahed El Makhzoumi, Beirut (Lebanon): El Tali'a Publishing House, 1987, page 13.

to restrictions, since it was permitted in England for banking companies to issue money notes by means of a legislation promulgated in 1833. The position of the Bank of England was cemented as a centre of the English banking system in 1854, when it adopted the plan of settling differences between the different banks at the end of each clearing or set off by using the transfers of these banks with the Bank of England.[1]

The central bank of France was founded in 1800 with a partial subsidy from the funds of the State. Its capital was private. Since its origin, it was closely connected with the government, for it became the banker of the government and the authorized to issue money notes. The country shared in its control over the management of the bank by appointing a governor and two assistant governors. In 1848 the central bank's assignments and capital were enlarged as a result of the conversion of nine banks, which had the right to issue money notes, into branches of the Bank of France. With the passage of time, other branches were established and the bank acquired the monopoly in issuing money notes in the whole of France.[2]

The Dutch Bank was established in 1814 after a loss of trust in the old Amsterdam Bank. The Dutch Bank was restrictively granted the right to issue notes, and thus became banker to the government. It was founded with a private capital.

The Bank of Spain was founded in 1856, which was the offshoot of the State Bank instituted in 1829. It had to participate with provincial banks in issuing notes till 1873. Its capital was out of private participations, with the government appointing its own governor.

---

1 Sayers R.S. *Central Banking after Bagehot,* Oxford (UK): the Clarendon Press, 1958, p.1-47. and see,
Hoyle, Ken & Whitehead, G., *Money and Banking Made Simple,* London (UK): Heineman publications, 1982, pp.18-34.

2 Ibid, p.38.

The Reich's Bank of Germany, which was founded in 1875, was an extension of the Bank of Prussia, which was partly State-owned. But the majority was of private participations.[1]

The Bank of Japan was constituted in 1882 to restore order after the commotions which prevailed because of the issuance of money notes by several national banks. These banks were asked to withdraw their banknotes within a specific period. The Bank of Japan got the sole right to issue banknotes. It was a joint stock company yet all the members of the board of directors, consisting of the governor and four directors, were appointed by the government.[2]

The central banking system was founded in the United States of America in 1914, in the form of 12 Federal Reserve banks. Each bank had authority over a specific region, with a Federal Reserve Board as a coordinator in Washington, D.C.[3] These banks were granted a partial right to issue banknotes. They became financial agent of the government and custodian of the reserves of the banks, together with being the last resort for lending in their own areas. The member commercial banks subscribed to all the capital of the Federal Reserve banks.[4]

Arab States followed suit. The Egyptian government thought of setting up a central bank when England went out of the

---

1 Hoyle, Ken & Whitehead G., *Money and Banking Made Simple*, op.cit., pp.39-40. and see,
Sayers, R.S., *Modern Banking*, Oxford (UK): the Clarendon Press, 1967, pp.78-81.

2 De Kock, M.H.G. *Central Banking*, op. cit., p. 14.

3 Auernheimer, Leonardo & Ekelund, R., *The Essentials of Money and Banking*, New York (USA): John Wiley & Sons, 1982, pp.209-227.

- Siegel Barry, N., *Money, Banking and Economy, A Monetarist View*, New York (USA): Academic Press, 1982, pp.149-181.

4 Goldfeld, Stephen M. & Chandler Lester, V.: *The Economics of Money & Banking*, New York (USA): Harper & Row, Publishers, 1985, pp.199-208.

- Auerbash, Robert D., *Money, Banking and Financial Markets*, New York (USA): Macmillan Publishing Company, 1986, pp.341-351
- Diulio, Eugene, A., *Theory and Problems of Money and Banking*, New York (USA): McGraw-Hill Book Company, 1987, p.107.

gold standard system in 1931 and after the recommendations of the International Economic Conference wherein Egypt had participated in 1923. The Egyptian government had to choose between setting-up a new central bank or to negotiate with the Egyptian National Bank and convert it into a central bank. The government chose the last solution for several reasons, the most important of which was the fact that the National Bank actually undertook some of the functions practiced by central banks such as issuing banknotes, operating as banker to the government and having acquired experience and know-how to this effect. In 1951, National Bank of Egypt was converted into central bank by legislation. Its control was expanded over other banks and the extent of government's control over the bank was increased. However, a large gap still remained regarding the control over credit issue. Therefore, the law was amended. Another law was promulgated in 1957, which enlarged the operational scope and range of the Central Bank, giving it the right of control over the operations of banks and in directing their activity in such a way as would agree with the general policy of the State.[1]

In the Kingdom of Saudi Arabia, King Abdul Aziz issued a royal directive on April 1952 on establishing the Saudi Arabian Monetary Agency (SAMA) to act as a central bank for Saudi Arabia, with its Head Office in Jeddah and branches in other cities. The statute of SAMA determined its objects, its authorized capital, its functions and the appointment of the members of its board of directors comprising a chairman, a deputy chairman, a governor and two members. They are appointed by His Majesty the King on the recommendation of the Minister of Finance.[2]

---

1 Shafei, Mohamed Zaki, *Introduction to Money and Banking*, Beirut (Lebanon): El-Nahda Printing and Publishing House, 1952, p.329.

2 Al-Haj Ali, Mohamed Said, *Saudi Arabian Monetary Agency, Its Foundation, March and Achievements*, Riyadh (Saudi Arabia): El-Ayyoubi Press, 1991, pp.25-32.

At present, no country is without a central bank. This follows several recommendations issued by the competent international authorities, including the World Financial Conference held in Brussels in 1920, which urged all countries to have their own central banks to restore not only stability to their currencies and banking systems, but also in the interest of international cooperation. The Conference said the central bank would provide the country with central cash reserves, control both credit and currency and achieve the optimum means of communication and collaboration with the monetary and banking systems in other countries.

The central bank has become an inevitable necessity. The functions of the central bank are distinct from the operations of commercial, industrial, agricultural and savings banks. The rules and methods adopted by central banks in practicing their operations have developed over the years. These rules will continue to develop and improve, being subjected to amendments and improvements from time to time and from country to country in accordance with the needs and aspirations. Therefore, I submit amongst the appendixes of this research work a schedule which indicates the establishment dates of central banks in various countries.[1]

(2) DEFINITION OF CENTRAL BANK:

The central bank is a bank which deals in credit, as do the other banks. But it differs from them in terms of its ownership, objectives, nature of operations, and the clientele.

Central banks do not usually have private ownership. They may either be wholly owned by the government or take the form of joint stock companies wherein a major part of the

[1] Appendixes of the research work, appendix No. (1), p.354

shares is owned by the government so as to control them. They may also be in the form of public authorities owned by the monetary institutions in society. Whatever the form of central banks in different societies, it is necessary that the government has adequate representation in the management so as to guarantee the possibility of laying down their policy and directing them, while reconciling between them and implementing the economic policy of the government to achieve public welfare.

As for the objectives of the central bank, we shall find out that they differ from the rest of the other banks. The main objective of commercial banks lies in achieving the maximum profit possible. As for central banks, their thrust is on achieving national objectives by controlling and directing credit and providing the market with money as would suit their requirements, controlling the quantity of money and influencing it as well as coordinating between the different commercial banks, and the settling their rights and obligations. The central bank, thus, plays the role of the principal bank in relation to the rest of the commercial banks by lending them and receiving their deposits. Realizing profit is not the main aim of the central bank.

In relation to the operations undertaken by the central bank, we shall find out that they are in harmony with the objectives of the bank, which is the national or public welfare. They play an important role by organizing the money supply in the country and through directing the credit towards certain sectors at various and different levels according to the directives of the economic policy of the country.

Although the central bank focuses on taking up the deposits of commercial banks and on controlling the credit, yet national welfare and community service are the dominant motive.

Dr. Shafe'i, of Cairo University, defined the central bank as being 'the authority that issues banknotes and guarantees throughout various means the safety of the banking system. It is entrusted with the supervision of the credit policy, inclusive of the consequences in terms of important effects on both the economic and social systems'.[1]

Others have defined the central bank as being 'a bank that stands at the crest of the banking system whether from the banknote issuance standpoint or from the point of view of banking operations and controlling them'.[2] Similarly, the central bank is 'the centre where banks keep their deposits, and the basic source of the new reserves. It is in charge of issuing banknotes in some states. It is the one that stands behind the banking system when the latter faces financial crises, and helps it tide over them. It is the entity that monitors and defines the credit policy, aiming to achieve stability in the monetary policy and the prompting social development process.'[3]

Dr. Alhassiya defines the central bank as: 'an institution which aims at controlling the volume of money and implementing the monetary policy of the country to achieve anticipated national economic objectives. It is a public institution and an independent executive body within the framework of the state, which practices its discretionary authorities in cooperation with the financial entity of the country to achieve and realize their aims.'[4]

According to this researcher defines the central bank as: an independent institution within the framework of the state, standing at the crest of the banking system. It undertakes

---

1 Shafe'i, Mohamed Zaki, *Introduction to Money and Banking*, op. cit., p.281.

2 Hashem, Ismail Mohamed, *Notes on Money and Banks*, Beirut (Lebanon): El Nahda El-Arabiyya House,1985, p.74.

3 Siegel, Barry, *Money, Banking and Economy, A Monetarist View*, Translated by Taha Abdallah Mansour and Abdel Fattah Abdel Rahman, Riyadh (Saudi Arabia): El-Marrikh House, 1987, p.225.

4 Al-Hassiah, Meloude Jomaa, *Money, Banks and Economic Activity*, Tripoli (Libya): Bulletins of the Scientific Research National Authority, p.127.

the designing and implementation of the suitable monetary and credit policy to achieve economic and national objectives. It is the last resort for all banks and financial institutions in a country. And it is the bank of the government.

From the definitions, we find that the central bank is but a bank which is mainly owned and controlled by the government as far as its activities are concerned. It has objectives of national welfare, stands at the top of the banking system, directs the credit policies, controls them, and aims at monetary policy stability, prompting the growth and development processes. It is the bank of banks, and the bank of last resort for them, in addition to being the bank to the government.

(3) MAIN FUNCTIONS OF THE CENTRAL BANK:

In spite of the similarity of the functions undertaken by central banks in various countries, the scope of these functions is determined by factors which differ from country to country. The factors that stand out in defining the functions of the central bank are extent of the money market, the extent of its organization, the extent of the country's economic progress, and the sort of economic organization under which it operates. The duties and functions of central banks grew, progressed and developed over the years. Central banks originated at first as mere commercial banks then it converted to play the role of the central banks by adding the functions of the central bank to their first duties.

The main functions for which central banks were set up were to issue banknotes and render services to the government. Out of these two functions grew offshoots. And since the system of central banks is continuously developing and functions expanding, we expect to see them in future taking on more responsibilities.

We list hereunder the most important functions undertaken by the central bank, and which we shall deal with in detail, in chapters four and five of this research work:

a) The central bank is the bank to issue money notes.
b) The central bank is the bank of the government.
c) The central bank is the bank of banks, and is the last resort bank for the credit system.
d) The central bank is the custodian of the international currencies reserves of the country.
e) The central bank is orientated for national economy in such a way as to reflect economic welfare.
f) The central bank is the one which monitors credit.

2.2.4 ISLAMIC BANKS:

Islamic banks, which are new in the banking field, have a different pattern of work and investment based on the system of partnership (Musharakah). They are primarily investment banks. Lending is not a fundamental element in their operation. So, they are not the same as the commercial banks - a credit trader. They also do not operate on the basis of usurious interests. It is worth to be noted here that some countries consider the Islamic banks as one of the main elements of its banking system, while others treat them as part of commercial banks.

(1) THE ORIGIN OF ISLAMIC BANKING:

Islam encouraged investment, but prohibited usury. In the light of this command, people started looking for appropriate investment. So they invested in trade, which consequently flourished. With the spread of Islam and its teachings all over the Arabian Peninsula, internal and external trade flourished. This led to the growth of banking activity in order to facilitate the funding and financing of trade and the handling of money and its transportation in between the commercial or trade centres. However, these activities were not conducted throughout a specialized bank as is the case nowadays. It was conducted through several persons who were trusted by people, for the depositing of their trusts and precious things with them. Each person was practicing a banking function or more than one banking work as known at present.[1]

People used to go to whoever they trusted for honesty and virtue to deposit their money and precious things. Prophet Muhammad was known for his honesty and integrity, so people used to deposit precious things with him. In relation to the investment, the people of Makkah were known for two kinds of investment: lending against usurious interests popular in pre-Islam times, and lending money in the form of a speculation share of profit (Mudarabah).[2] Muslim money-exchangers also undertook other unconventional activities unknown in previous civilizations or which were known in previous civilizations on a limited scale. They popularised the issue of deeds, money orders, and the drawing of the bill or draft. This facilitated trading business and spurred their credit activities.[3]

It is worth mentioning here an incident about a follower of the Prophet whose name was Al-Zobeir Ibn Al-Awwam.[4] He was contacted by the people to deposit funds. Yet he refused to take the deposits, preferring to take these funds as loans. He did so with two objectives; that he would have total freedom to dispose of the funds delivered to him as loan not as a deposit, and that he would have guarantee of the owner of the money.

---

1 Al Heeti, Abbdulrazzak, *Al Masarif Al Islamiyah: Alnazariyah wa Al tatbeek (Islamic Banks, Theory and Practice)*, Amman (Jordan): Dar Osama for publishing and distribution, 1994, p.36.

2 Ibid., p.37.

3 Hammoud, Sami, *Tatweer Al Aamal Al Masrafiyah bima yatafiq wa Al Sharia Al Islamiyah (Development of Banking Operations in Agreement with Islamic Rules)*, Amman (Jordan): Al Sharq printing, 1982, p. 44.

4 El-Zobeir Ibn El-Awwam is a relative and follower to profit Mohammed.

After Al-Zobeir's death, his son Abdullah refused to divide the inheritance among his brothers until the debts had been repaid. For four consecutive years he would go out during the pilgrimage seasons and call out: Whoever has a loan on Al-Zobeir should contact us. After four years, he started dividing his father's inheritance which amounted, at that time, to Thirty Five million and Two Hundred Dirhams, a huge amount for that time.[1]

Al-Zobeir Ibn Al-Awwam had set a new trend, a shift from the concept of deposit as a trust to it having become a loan. We also notice that there were a large number of depositors at that time. That is why Al-Zobeir Ibn Al-Awwam was trusted with deposits as loans. Al-Zobeir's activity was nothing but that of a bank, the Head Office of which was at Madinah, with branches in Alexandria, Basrah and Kufah.[2] He used to undertake investments and business from the people's funds as well as the financial transfer operations between his Head Office in Madinah and the rest of the cities.[3]

The Muslim money-exchangers transferred funds without a tangible and concrete transfer of the money, relying only on documents, deeds and the repayment of the debt. The early Muslim money-exchangers knew the bills of exchange and the Sokouk which is the payment deeds. These practices were then transferred from Muslim money-exchangers to non-Muslims in neighboring countries by way of commercial and trading contacts.

---

1 Ibn Saad, Mohammed, *Al-Tabaquat Al-Kubra (The Big Layers)*, Beirut (Lebanon): Beirut Printing and Publishing House, Vol.3, 1957, pp.108-109.
Al Tabaqat Al Kobra, is a book that concentrates on science of pedigrees. This book gives details about the Islamic scholars, their life history, books, and their specialists. The writer of the book is Mohammed Ibn Saad who is famous in the field of pedigrees. Hi died in year 230 H.

2 Madinah is a holy city in Saudi Arabia; Alexandria is a city in Egypt, while Basra and Kofah are cities in Iraq.

3 Al Ali, Saleh Ahmed, The *social and economic organization in Basrah in the first century Hegira*, Beirut (Lebanon): Dar Al Taleya for printing and publishing, 1969 [2nd edition], p. 295.

With respect to the financial investment, it was made through money-exchangers, traders and their agents, who collected funds and invested them directly or in cooperation with third parties. The best form of investment available at that time, for whoever could not invest his funds by himself, was that of speculation (Mudarabah), which had proved in the past the efficiency as a means of financing under various economic and social conditions. It was an acceptable method of investing other people's funds.[1]

(2) ISLAMIC BANKS IN MODERN ERA:

Conventional banks and financial institutions grew so much so that they became an inevitable necessity in all societies. Since most conventional banks deal in interests, which is against Islamic tenets, some Muslims preferred not to deal with conventional banks. They started looking for legitimate source for investment which would enable them to invest their funds instead of storing them.[2] Some of these people went, with their funds and precious things, to traders or industrialists, asking them to invest their funds on their behalf and for their account. Many of these people fell victims to fraud and treachery. In other cases, people suffered huge losses because of the inexperience of those entrusted with investment. As a result, people got suspicious of traders and investment organizations. The

---

1 Hammoud, Sami, *Tatweer Al Aamal Al Masrafiyah bima yatafiq wa Al Sharia Al Islamiyah*, op. cit., pp.40-47.and, Al-Serraj, Mohamed Ahmed, *Al Nizam Al Masrafi Al Islami (The Islamic Banking System)*, Cairo (Egypt): Dar Al Thaqafah for Publication and Distribution, 1989, pp.17-20.

2 Al Najjar, Ahmed, *Limaza Nataamal Maa Al Bonouk Al Islamiyah (Why we deal with Islamic Banks)*, a research submitted to the International Union for Islamic Banks in Cairo (Egypt), September 1991, p.24. According to this research, at least 14% of the Muslim population in many Islamic countries especially in the Middle East (Saudi Arabia, Egypt, Syria, Sudan) and in other Islamic states such as Pakistan, Iran and Malaysia are avoiding to deal with conventional banks since they deal with prohibited interest.

people preferred to keep money in the safety of their homes[1].

This had bad effect on the economy. Some governments in Islamic countries realized the danger because of the stagnant money. They started thinking about felicitating legitimate fields of investment in line with the Islamic Shariah. Some Islamic countries planned to set up Islamic banks to invest people's money in the wheel of development through lawful channels. Other Islamic countries encouraged the wealthy and the enthusiastic people to set up organized and legal institutions, to operate under the control and supervision of the governmental authorities in line with the Islamic laws[2].

The moment this experiment was made, it met with great success. The idea of Islamic banks and Islamic financial institutions spread in several Islamic countries and even in non-Islamic countries in Europe and the US.[3]

While the idea of Islamic banks was met with encouragement and was welcomed by many Islamic governments, some Islamic countries did not authorize the establishment of such banks and disapproved of their existence for political, economical or other considerations. Some countries cited their inexperience while expressing their objection to the idea of an Islamic bank. Some countries did not allow the

---

1 Masoud, Ahmed, Daur *A Benouk Al Islamiyah Fi Al Dowal Al Namiyah (The role of Islamic banks in development countries)*, Jeddah (Saudi Arabia): Islamic center for research and training (Islamic Development Bank), 1998, p.73.

2 As the case of Saudi government which encouraged money exchanger and the conventional banks to open sections for Islamic transactions in their institutions, An interview with the deputy governor of Saudi Monetary Agency, Al Watan newspaper, Abha (Saudi Arabia): 28 December 2004, p13.

3 Check page no.5 of this research work for more details and information about some conventional banks which announced the setting up of branches for Islamic banking transactions.

establishment of Islamic banks under the pressure and influence of the leaders of conventional banks.[1]

The first attempt to set up an Islamic bank was made in Egypt in 1963 by means of what was at that time known as the local savings banks when the Egyptian government agreed with a delegation from West Germany to encourage the local or domestic savings and have them invested according to the beliefs of the citizens and their personal values.[2] This agreement resulted in the setting up of a branch of the local savings banks as an experiment which would be evaluated prior to propagating it on the level of the whole Arab Republic of Egypt.

In July 1968, the number of depositors swelled from 1,000 to more than 350,000. That number went on increasing until it reached about a million in 1972, after the expansion of this experiment in Egyptian villages and cities.[3] This massive growth in just nine years proves the success of the idea of setting up interest-free local savings banks. The aim of the officials in charge of this project was to accustom the limited income holder, especially farmers, to save and thus participate in the development of small rural projects, and to help these depositors by granting them non-interest loans. These banks avoided the dealing in interest and worked towards replacing interest-based lending by partnership (musharakah) and speculation (mudarabah). In

---

1 Statements by bank officials in several Islamic and non-Islamic countries about the difficulties in dealing with Islamic banks, of which a statement made by a responsible official of the Bank of England (Michael Inley) before the Islamic Banks Conference which finished its works in London on 23/4/1996. An article in Al Sharq Al Awsat (the Middle East Review) dated 24/4/1996, p. 15, said: "An official of the Bank of England says before a conference in London: We face dealing difficulty, together with the conflicting performance criteria of Islamic banks."

2 Ridy, R. K., *Al Mujtamaa Al Arabi Fi Marhalet Al Taghyeer (The Arab Society in acountryof Change)*, Translated by Ahmed Abdel Aziz El Najjar, Cairo (Egypt): International Union for Islamic Banks, 1981 [2nd Edition], p.30.

3 Al-Serraj, Mohamed Ahmed, *Al Nizam Al Masrafi Al Islami (The Islamic Banking System)*, op. cit., p.37.

July 1971, the Egyptian Central Bank took practical steps towards assigning the task of the saving banks to the conventional commercial banks. Despite this the experiment went on due to the strong and valid foundations of these banks. They were the nucleus wherefrom sprang the idea of Islamic banks.

From the success of the experiment in Egypt, officials planned to set up another interest-free bank based on the principles of partnership (musharakah) and speculation (mudarabah). The bank started actual activity in July 1972. Article Three of the draft law of the article of association of this bank stipulated that it is not permissible for the Nasser Bank Authority to deal with others on basis of interest system. This stipulation includes staying away from usury. It calls for endeavors to adopt religiously lawful methods of financing when investing funds and to abide by the provisions of Islamic teachings.[1]

Then the Islamic Development Bank (IDB) was established in Jeddah, in the Kingdom of Saudi Arabia, in August 1974. It was an offshoot of the Organization of the Islamic Conference (OIC). IDB was officially inaugurated in October 1975 with the membership of 42 OIC countries and with a capital of two billion Islamic Dinars. Article One of the article of association of IDB stipulated that compliance with the provisions of Islamic law in its transactions must be observed. IDB differs from other Islamic banks in that it is an international organization having special objectives of providing aid and enhancing cooperation among OIC member states and upholding their developmental efforts.[2]

The movement of setting up Islamic banks in other Islamic countries continued, and by 2004 about 208 Islamic banks and

---

1 Ibid, p. 39.

2 Al-Jammal, Ghareeb, *Al Masaref Wa Biuet Al Tamweel Al Islamiyah (Banks and Financing Houses)*, op. cit., pp.207-296.

financial institutions came into operation in 40 countries.[1] I submit amongst the appendixes of this research work here a schedule that lists some of these institutions, the date of their establishment and the country where they are based.[2]

The leadership of the conventional banks noticed the popularity of Islamic banks. So, they set up branches for Islamic transactions and operations inside the conventional banks.[3] But despite the success of these banks none of them has yet reached the level of a major bank in terms of liquidity, investments or services. This is natural because Islamic banks are still in the early stages of development. But the results achieved and the volume of operations realized by them and the enthusiasm shown by the people augur well for Islamic banks.

Islamic banks are developing fast, adopting modern technology and discarding un-Islamic banking practices.

(3) DEFINITION OF ISLAMIC BANK:

There is no fixed definition of the Islamic bank. We cannot say that the Islamic bank is the bank that does not deal in interests, since this meaning is very narrow. There have been several attempts by experts to find a befitting definition of the Islamic bank. Some of them defined the Islamic bank as being 'the Islamic financial institution which undertakes all banking, financial, commercial and investment operations, together with industrial and economic development at home and overseas'.[4] Others defined the Islamic bank as 'a financial and banking institution for the

---

1 Source: *Islamic finance Directory 2004*, Manama (Bahrain): Published by General Council for Islamic Banks and Financial Institutions, 2004.

2 Appendixe of the research work, appendix No. 2, p.360

3 Some information about some conventional banks which announced the setting up of branches for Islamic banking transactions is stated in page 5 of this research work.

4 Al-Najjar, Ahmed, *100 Questions and 100 Answers about Islamic banks*, Cairo (Egypt): International Union for Islamic Banks, 1978, p.127.

collection and placement of funds within the framework of Islamic Shariah in such a way as to serve the idea of building society on equity and Islamic justice'.[1]

Ghareeb Al-Jammal defines the Islamic bank as 'an institution that practices banking operations while avoiding dealing in usurious interests'.[2] And, Nasr El-Dine Fadl El-Moula defines the Islamic bank as 'a financial institution that endeavors to achieve the material interests accepted by the Islamic Shariah by collecting financial resources and directing them to the optimum use'.[3]

Taking into account all these definitions, a comprehensive description of the Islamic bank emerges as it being, a financial institution which practices interest-free banking and which abides by the Islamic Shariah while collecting funds and savings, and investing them with the aim to achieve social justice and development. From this definition we find that the Islamic bank is nothing but a financial institution which differs from the remaining commercial, industrial or servicing organizations in its objectives, activities and nature of operations.

(4) THE MAIN FEATURES OF ISLAMIC BANKS:

Islamic banks have a special nature of their own which distinguishes them from commercial and conventional banks. First of all, it is connected with the teachings of Islam. Listed here are the important features of Islamic banks:

A) Islamic banks are the banks which embody Islamic principles in global compliance.

---

1 Al-Faisal, Prince Mohammed, *Banks and Insurance in Islam*, Islamic Banks Magazine, Issue No. 73, Cairo (Egypt): International Union for Islamic Banks, 1983, p.33.

2 Al-Jammal, Ghareeb, *Al Masaref Wa Biuet Al Tamweel Al Islamiyah (Banks and Financing Houses)*, op. cit., p. 45.

3 Mohamed, Nasr El Dine Fadl Al-Mawla, *Al Bonouk Al Islamiyah (Islamic Banks)*, Jeddah (Saudi Arabia): Dar El-Elm for Printing and Publishing, 1985 [1st edition], p.25.

B) Islamic banks are financing banks by participation whose base and prop lies in investment.

C) Islamic banks endeavor towards the development of societies and consider overall development as one of their aims.

Here we will explain these features in brief:

A) ISLAMIC BANKS EMBODYING ISLAMIC PRINCIPLES IN GLOBAL COMPLIANCE:

The Islamic bank is constituted on the principles of Islamic Shariah. Therefore Islamic banks are part of a general Islamic system whose task is to serve the Islamic society and community.[1] The Islamic bank derives its laws from the principles of Islamic economy. Thus the services and all elements of operation such as financing, labour and the wage ratio should subscribe to Islamic teachings.

Thus Islamic banks may not finance the production of prohibited commodities such as liquor or the export of pork and its derivates or the setting up and maintenance of gambling halls and nightclubs.[2] Islamic banks do not deal with institutions dealing in usury. For it is a must that resources and savings would be canalized towards the production of commodities and services which would satiate leveled needs for the Moslem individual, provided that would be admissible by canon Islamic law, taking into consideration and calculations the interest of the Moslem society or community as a whole.

B) ISLAMIC BANKS AS FINACING BANKS BY PARTICIPATION WHOSE BASE AND PROP LIES IN INVESTMENT:

The conventional banks especially the commercial banks rely on loans in the placement of their funds. Difference between

---

1 Al Hawari, Sayed, *Mamaana Bank Islami (What is the Meaning of an Islamic Bank)*, Cairo (Egypt): International Union for Islamic Banks, 1982, p.12.

2 Mohamed, Nasr El Dine Fadl El-Mawla, *Al Bonouk Al Islamiyah (Islamic Banks)*, op. cit., p.15.

the credit and debit interests forms an important source of their profits. This is contrary to Islamic banks where dealing in usury is prohibited. That is why Islamic banks invest directly or through partnership (musharakah). Investment is the basis of the Islamic bank.

The investment method in Islamic banks depends on partnership (musharakah) which means the participation of Islamic banks in the capital of a project as a partner or shareholder in the ownership, management and control and sharing profit and loss. Hence exploitation - which is part of commercial banks - is absent in Islamic banks. Islamic bank seeks out investments opportunities and studies the economic feasibility of new projects sincerely and honestly. It may undertake the investment operation alone or in partnership with others. That is why Islamic banks concentrate on the economic study of projects to lessen the risk factor and in order to achieve the security and success elements for such investments. Accordingly, the Islamic bank is an investment bank. This differs from the banking concept by means of which operates the conventional investment bank, since the interest factor is the operational axis of the conventional investment bank.

C) ISLAMIC BANKS WORK FOR COMMUNITY DEVELOPING:

Islamic banks direct an important part of their activity towards the development of the Islamic societies. Development in favor of society is the motto of Islamic banks. By development here we mean not only economic but overall development. Islamic Banks Encyclopedia referred to this concept: 'The partnership (musharakah) system aims at developing the economies of the Islamic world. But the basic and fundamental indictor for it is profit without interest, side by side with other social considerations such as labour, the welfare of society, its needs and requirements.

Hence the motto of the Islamic bank is development for the welfare of society'.[1]

We can prove the active role of the Islamic bank in economic development. In the field of savings, we find that the existence of Islamic banks led to an increase in the bank liquidity by attracting idle funds which were not put in commercial banks because of the involvement of usury. Therefore, emergence of Islamic banks had a positive impact on the volume of savings. These savings went into the development process.[2]

As far as the field of investment is concerned, we find that under the Islamic banking system it is assumed that Islamic banks would direct themselves towards the profitable investment opportunities and that they would seek out projects of economic feasibility instead of concentrating on the financing of conventional projects which rely on the solvability of the customer and his financial potentials as is usually the case when marking loans in commercial banks. Islamic banks through partnership in profit and loss, select the best and the most feasible projects.

Islamic banks also help bring down inflation by boosting productivity which bridges the gap between the offer of commodities and services and demand. This results in price stability.[3]

---

1 *Encyclopedia of Islamic Banks*, International Union for Islamic Banks, Cairo (Egypt), 1982, Vol. 1, p.14.

2 Al Najjar, Ahmed, *Limaza Nataamal Maa Al Bonouk Al Islamiyah (Why we deal with Islamic Banks)*, a research submitted to the International Union For Islamic Banks in Cairo (Egypt), September 1991, p.24. According to this research, at least to 14% of Muslims in many Islamic countries especially in the Middle East (Saudi Arabia, Egypt, Syria, Sudan) and in other Islamic states such as Pakistan, Iran and Malaysia avoid conventional banks because of the involvement of usury.

3 Jamal, Mohamed Salah, *Daur Al Bonouk Al Islamiyah Fi Al Tanmiyah Al Iqtisadiyah wa Al ijtemaiyah (The Role of Islamic Banks in the Economic and Social Development)*, Amman (Jordan): publications of the Jordanian Central Bank, 1991, pp.9-13.

Instability of money resulting from over production of banknotes vis-à-vis commodities and services is the main cause of inflation today. A country cannot increase the quantity of money if production is not increasing. Any increase in the quantity of money that exceeds the value of the total product of commodities is considered, from the Islam viewpoint, as devouring people's funds.[1]

The role of Islamic banks in social development stems from the Islamic principle of equity and social justice. The social aspect is one of the main pillars on which is built the Islamic economic system, of which Islamic banks constitute an important part. Zakat (alms)[2] is one of the most important social aspects of Islamic banks, wherein Islamic banks establish special accounts and ask people dealing with them to pay zakat. These banks also distribute funds to the beneficiaries. This is considered one of the most important social aspects of Islamic banks, because the alms (zakat) help fight poverty and narrow the class gap.

Islamic banks participate in social development by way of providing beneficial loans without return to the needy such as students for study, to the sick and the poor, and in certain cases for productive purposes with the aim of investing them in small projects.[3]

---

[1] Al Lutah, Sa'eed Ibn Ahmad, *(The Nature of the Bank Under the Capitalistic, Socialistic and Islamic Systems)*, Abu Dhabi (United Arab Emirates): Islamic Banking Conference, 1985 [3rd edition], p.56.

[2] Zakat is that part of money in which the rich people give a certain amount to the poor in compliance with Islamic teachings.

[3] Jamal, Mohamed Salah, *Daur Al Bonouk Al Islamiyah Fi Al Tanmiyah Al Iqtisadiyah wa Al ijtemaiyah (The Role of Islamic Banks in the Economic and Social Development)*, op. cit., pp.15-16.

(5) THE MAIN DIFFERENCES BETWEEN ISLAMIC AND CONVINTIONAL BANKS:

There are many differences between Islamic and conventional commercial banks, we shall explain those differences hereunder:[1]

A) ISLAMIC BANKS DO NOT DEAL IN INTEREST:

The conventional commercial banks rely on interests for profit. Islamic banks do not deal in usury in compliance with the Islamic teachings. Many Quranic versions and sayings of the Prophet dealt with the issue of usury. 'O ye who believe! Devour not usury, doubled and multiplied; but fear Allah; that ye may relay prosper'.[2]

'O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take a notice of war from Allah and his messenger; but if ye turn back, ye shall have your capital sums; deal not unjustly, and ye shall not be dealt with unjustly.'[3] Moreover, in Al-Baquarah there has been mention of the banning and prohibition of dealing in usury, '...But Allah hath permitted trade and forbidden usury....'.[4]

That is why Islamic banks use investment methods which are authorized by Islamic Shariah. These are interest-free investment based on the principle of sharing in profit and loss.

B) THE ISLAMIC BANKS LEAN ON INVESTMENT, WHEREAS CONVENTIONAL BANKS ARE BASED ON LENDING:

We have previously made clear in the preceding paragraph that the conventional banks rely on lending at a rate of interest which is higher than the rate of interest on which they borrow. Since Islamic banks do not deal in usury, they

---

1 Mohamed, Nasr El Dine Fadl El-Mawla, *Al Bonouk Al Islamiyah (Islamic Banks)*, op. cit., pp.19-24.

2 *The Holy Quran*, Surah of Al-Imran, verse 130.

3 *The Holy Quran*, Surah of Al-Baqarah, verses 278-279.

4 *The Holy Quran*, Surah of Al-Baqarah, verses 275.

seek out for themselves the fields of activity to realize profit. The difference is between lending in conventional banks and investment in Islamic banks. For when the commercial bank lends, its responsibility ends up when marking the facilities, taking the pledge, and taking up of securities and guarantees. It does not care about the success of the project in which the fund has been invested. On the contrary, Islamic banks look out for investments, selecting the best opportunities available. It, thus, undertakes all the feasibility studies of the new projects. It may undertake the investment operation alone, or in partnership. It, is therefore, affected by the outcome and results of such investment, both negatively and positively.[1]

C) DIFFERENCE IN OBJECTIVES:

The basic objective of conventional banks is the realization of the maximum profit rate possible. To achieve this objective, they rely on solvent investors, macro-projects and on the loans of a short repayment period, regardless of the kind of project. They also do not care much about the social aspects, concentrating their investments on the basic services areas regardless of developmental concerns. Therefore, we find that even if commercial banks undertake development operations, they are governed by their prime objective of making profit. As for the Islamic banks, the objectives are numerous. The objective of achieving profit for the survival of the bank is realized through investment in viable projects, duly and thoroughly studied, and taking into consideration developmental, social and humanitarian objectives.

D) DIFFERENCE IN THE FUNCTION OF THE CAPITAL:

Islamic banks mix their capitals with the funds of the investment deposits. They look for their investment opportunities through sharing and partnership (musharakah).

---

1 *Encyclopedia of Islamic Banks*, Cairo (Egypt): International Union for Islamic Banks, Vol. 2, 1982, p.101.

Thus, all bear profit or loss. As for the commercial banks, their capital which is included in their operations, investments and activities, is a modest amount in comparison to the deposited amounts. To protect the funds of these depositors, the central banks impose upon the commercial banks to retain a legal liquidity rate with it.

E) DIFFERENCE IN THE BASES OF BANKING FINANCING:

It is agreed upon that when any bank provides facilities to a customer it follows certain criteria which it adopts and follows. The commercial banks determine for themselves the criteria. These criteria may not exist in all banks. These criteria are: the object of the financing or funding, the financing period, the risks to which the financing could be exposed, the availability of sufficient securities and guarantees for the redemption or repayment of the financing, the anticipated fixation of the rate of interests, and the preference of large projects and organizations which need a sizeable financing or funding.[1] As for the Islamic banks, we find that they have different criteria, such as:[2] the financing or funding of investment projects for use and welfare of society, diligence paid to the investment projects subject to the financing being acceptable by Islamic law, working and operating in partnership with the owner of capital or customer and the banning and prohibition interests in the transactions.

F) THE DIFFERENCE IN THE STRUCTURE OF DEPOSITS:

Islamic banks concentrate their efforts on investment, commercial and conventional banks focus their efforts on lending to benefit from interest. Because of this difference, we find that the structure of the deposits in each of the two sorts of banks differs. The structure of

---

1 Suwelam, Mohamed Mohamed, *Ausus Al Tamweel Al Masrafi Fi Al Bonouk Al Islamiyah (The Bases of Banking Financing in the Islamic Banks)*, a research presented at the Investment and Financing Programme, held at the King Abdel Aziz University in Jeddah (Saudi Arabia): December 1980, p.5.

2 Ibid., p. 4.

deposits in commercial banks is mostly characterized by current deposits or credit current accounts. In Islamic banks, the investment deposits or investment accounts stand in the first place in the structure of deposits.[1]

G) THE DIFFERENCE IN THE SECTIONS OF THE ORGANIZATIONAL STRUCURE:

The framework of the organizational structure of any commercial, conventional bank is nearly the same due to the similar nature of operations of these banks. In Islamic banks, the sections of the organization structure vary. In addition to the sections existing in the conventional banks, Islamic banks have some other sections because of its special nature of operation. Islamic banks have a department for legislative control, which undertakes all Islamic legislative control of all the operations and activities of the bank. There is a special department for the management of the alms (zakat) funds. This is in addition to the difference in the operations and sizes of some departments, and their relative weight in relation to the remaining departments of the bank, such as the Investment Department, the Follow-up and Implementation Department.

CONCLUSION

The discussion in this chapter is focused on the components of the banking system. It becomes clear that the banking system in any country consists of several institutions which practice a grope of banking activities. It consists of the central bank at the top of the banking system, in addition to the commercial banks and specialized banks. Over the years Islamic banks became an important element of the banking system.

The bank and the central bank were defined, and the subject of the origin of the central banks and their developments

---

1 Shehadah, Shawki Ismail, *A 1 Bonouk Al Islamiyah, (Islamic Banks)*, Jeddah (Saudi Arabia): Dar El-Shorouk, 1977 [1st edition], p.68.

was also reviewed. It is noted that central banks came into being long time after the commercial banks, and at present, the activity of central banks has become an inevitable necessity. This is why there is no country in the modern world without its own central bank.

The duties and functions of central banks were explored. These functions have grown, progressed and developed with the passage of time. Many central banks originated at first as mere commercial banks. The primary functions on which central banks were set up were those of issuing banknotes, and rendering services to the government. Out of these two functions came other responsibilities undertaken by the central bank in its modern position as its role for controlling the credit, bank of the banks and the last resort for the banking system.

In this chapter we also discussed the origin and development of Islamic banks. It is observed that some of the banking activities prevailing at present were in practice in ancient times under the early Islamic civilization. Some of these activities existing now are even nothing but a natural extension and development of what was known in those eras and ages at the outset of Islamic civilization. And for the origin and development of the Islamic banks in the modern eras, this part of the research shows that the first attempts to set up an Islamic bank was made in Egypt in 1963 by means of what was at that time known as the local savings banks. Later on, Islamic banks developed and expanded until they reached this advanced level.

Finally, in this chapter the Islamic banks were defined and the main features of Islamic banks were highlighted, and main differences between Islamic and conventional banks were stated.

CHAPTER 3

THE REASONS FOR SETTING UP ISLAMIC CENTRAL BANKS

INTRODUCTION:

To understand the importance of setting up Islamic central bank, which can control and assist Islamic banks in various parts of the world, we must clarify and illustrate the present environment in which Islamic banks operate and the problems they face.

After reviewing the working environment of the present Islamic banks, we propose and suggest, in this part, the most suitable specimen through which the Islamic central bank would be able to direct and control all Islamic banks operating under its supervision. Thus, in this chapter the researcher will elaborate the reasons for setting up an Islamic central bank, which understands the operating nature of banks under its purview and directs them to the right path which would suit the expectations, aspirations and goals of the economic and monetary policies of a country.
This chapter will define the proposed Central Islamic Bank, with an attempt to find a comprehensive definition that would clarify its characteristics, differentiating it from the conventional central banks.

Since the most important requirement for establishing Islamic central bank is to avoid dealing in the banking interest (usury) which is prohibited in Islam, the researcher finds it important to concentrate in this chapter on describing the banking interest and its relationship with the prohibited usury, together with the explanation of the meanings of usury, its kinds and evidence from the holy Qur'an and the Sunnah of it being banned.

3.1 THE OPERATION ENVIRONMENT OF THE PRESENT ISLAMIC BANKS:

Central banks have become a must. For the central banks to be in a position to play their role competently and efficiently, it is a must to use some instruments and functions which would assist them in reaching the anticipated objectives. These instruments and functions adopted by the conventional central bank can be found to be applicable in the various human States and societies. Yet, their application in the Islamic societies which apply the basics of Islamic economy dictates it upon us to undertake an accurate review and revision of these instruments, functions and means. Therefore, it is a must to submit them to the gauging of Islamic legislation to make a sifting thereof, adopting what is in conformity with Islamic legislation, and amending what is in contradiction with it. If we cannot amend them for one reason or another, we can always substitute them with new Islamic functions and instruments which would perform the same task and play the very same role.

We find out that the relationship between Islamic banks and conventional central banks is still unclear in several fields, the most salient of which are the fields of the last resort lender, the lending and borrowing operations and the banking and credit ratios which are imposed by the central banks. Central banks cannot effectively supervise the operations of Islamic banks unless the central banks are in a position to understand the operating nature of the Islamic banks.[1]

At present the nature of the relationship between the Islamic banks and the central banks differs from one country to another, according to the legal framework which regulates the positions of the Islamic banks in these countries. Three specimens emerge from this relationship:[2]

---

[1] El Rabi'ah, Saoud Mohamed, *Tahweel Al Msref Al rebawi Ela Masref Islami, (The Conversion of a Usurious Bank into an Islamic Bank)*, Kuwait: Center of Al Manshorat, Al Makhtotat Wa al Wathaeq, 1991, pp.317-333.

[2] Al Heeti, Ab bdulrazzak, *Al Masarif Al Islamiyah: Alnazariyah wa Al tatbeek (Islamic Banks, Thiory and practice)*, op. cit., pp.692-700.

The first specimen is the countries like Iran, and Sudan which have converted their banking system in full into the Islamic system. The relationship between the central bank and the Islamic banks here is determined by rules which follow the principles of the Islamic banking activity. The central bank of these countries undertakes the tasks of supervising the Islamic banking units and controlling their operations without conflicting with the objectives and policies.

In the second specimen come the countries which have authorised the setting up of Islamic banks, promulgated laws and earmarked for them governmental agencies to supervise their activity. Malaysia, Turkey, the United Arab Emirates, Kuwait, Bahrain and Jordan fall in this category. In these countries, Islamic banks are controlled and supervised by special agencies, in the central bank, different from those governing the conventional banks. In some cases, Islamic banks and conventional come under one agency, but having rules, laws and regulations which suit their respective nature and activities. The relationship between central banks and Islamic banks is harmonious since procedures are governed by the Articles and items of the laws set down.

In specimen three come the countries which set up Islamic banks under strength of exceptional and special laws so that these banks are directly under the supervision of central banks which monitor, regulate and organize the transactions exactly the same way as the conventional banks. They follow the same systems and statutes applied to conventional banks. Most of the Islamic banks spread out at present all over the world undergo these circumstances and are classified under this category. The examples of this category are Egypt, Saudi Arabia, Lebanon, Qatar, Tunisia and other countries. In this category, Islamic banks - by way of their nature and features which differentiate them from other conventional banks, in addition to the sort of relationship between them and their customers - find themselves in real trouble as a result of the conventional control methods used by the central banks. This leads to conflicting objectives and policies between the central bank and the Islamic banks.

After having reviewed the three specimens under which Islamic banks operate, we can confirm that the first is the ideal. According to this specimen, the existence of any conventional banks or financial institutions operating in contradiction to the doctrines of Islamic law is rejected. The central bank which controls and supervises all the banks operating within the boundaries of the country is the specimen for the Islamic central bank.

As for the second and third specimens, we find that Islamic banks operate within a conventional economic system. They are subjected to the supervision and follow up by agencies inexperienced in the field of the Islamic economic system. Islamic banks cannot operate efficiently unless the environment in which they work is Islamic, being governed by laws and systems in harmony with the Islamic Shariah.[1]

And since the countries of the two specimens, have admitted the importance of the role of Islamic banks and have authorised them to carry out their operations, the authorities in these countries must provide them with conducive environment. If the countries of these two specimens are desirous of preserving the conventional economic system while simultaneously endeavoring to provide the suitable operating environment for the Islamic banks, they will have to choose one of the two following alternatives:[2]

---

1 Al Hindi, Adnan, *The relationship between the Islamic banks and the central banks*, Amman (Jordan): Banks Magazine, 1st. Issue, 1984, pp. 3-19.

2 Al Tamimi, Yunis, *The relationship between central banks and the Islamic banks,* a working paper presented to the Islamic Development Bank seminar about the relation of the central bank with the Islamic banks, Jeddah (Saudi Arabia): 1991, pp.7-11.

A: To set up an Islamic central bank inside the boundaries of the country, whose instruments, methods and functions are Islamic, enabling it to supervise and control all Islamic banks under its purview. Simultaneously, there would be another conventional central bank which would control and monitor non-Islamic conventional banks, operating according to conventional laws, systems and functions.

The researcher deems that this choice may not be practical as it assumes the presence of two central banks in one country. This would mean the existence of two monetary authorities in the same country. However, some countries may still wish to adopt it and put it into practice. As for those countries which do not wish to adopt this option, they can select the other alternative.

B: To set up a special body as part of the conventional central bank to control and monitor the Islamic banks. The staff members of this body must be well versed with the Islamic banking system and are aware of Islamic laws. Administratively, this agency would be attached to the supreme leadership of the central bank.

If such a body exists as part of the central bank, this would mean a tight control and follow up of the Islamic banks, in addition to control and monitoring of other conventional banks. Accordingly, there will be only one central bank in a country, but in the form of two separate entities - one for the control and follow up of the conventional banks, and the other for the follow up and control of Islamic banks.

Whether the authorities adopt the first alternative or the second, they shall have to find a system for the Islamic central bank which would abide by the Islamic teachings and through which they could design and implement the monetary and economic policies and monitor the performance of Islamic banks under its purview.

3.2 REASONS TO SET UP A CENTRAL ISLAMIC BANK:

The researcher determined the reasons which call for the creation of a Central Islamic Bank as follows:

A: Islamic banks have spread out in several countries. They have gained success and popularity. In several countries, they are now a necessity. We have previously indicated that these banks have a nature and characteristics which distinguish them from other conventional banks. Therefore, we shall find out that conventional central banks are not qualified to supervise and control Islamic banks due to this such distinctive nature of Islamic banks which is difficult to grasp or understand by those in charge of the central banks, and to all staff' members therein.[1]

B: That the mechanism used by the conventional central bank in supervising and controlling the regular commercial banks is unfit for Islamic banks, as most of them are not in conformity with Islamic teachings and conflict with the objectives for which Islamic banks were set up. That is why it is a must to Islamise these instruments and methods.[2]

C: That most of the staff members working in conventional central banks totally ignore the operations and activities of Islamic banks. That is why it would be unfair and unwise to expect these staff members to undertake the supervision, control and follow-up operations of Islamic banks.[3]

---

1 Kamel, Saleh Abdullah, *Islamic Banking Activities and the controlling role of central banks*, a research presented at seminar on Islamic Banks: the fact and practical application, Amman (Jordan): December 1988, p.3.

2 Ibid, p.5.

3 Ahmed, Mohye El Dine Ahmed, *The Role of the Central Bank in Relation to the Islamic Bank,* a research presented to the Islamic Development Bank seminar about the relation of the central bank with the Islamic banks, Jeddah (Saudi Arabia): 1991, pp.8-10.

D: That the central banks heed the control of credit and money supply to achieve the currency value stability. They also aim at achieving the economic and social objectives. This cannot be achieved except through the control of all banks operating within the boundaries of the country. Therefore, central banks must not ignore the existence of Islamic banks, and must recognise their role and effect on economic life.[1]

E: Islamic banks need an authority for support and back up. It should be their savior and helper in case of crisis or when they need additional liquidity. These banks must gain the confidence and trust of customers. This cannot be achieved unless the clients know that there is an important authority which supports these banks in case of crises. This important authority is the Islamic central bank.[2]

Thus we deduce that the Islamic central bank is needed for the sake of Islamic banks and financial institutions. Furthermore, the Islamic bank needs the trust and confidence of its clients which it cannot win unless they know about the existence of a central bank to support the Islamic bank in crises. Similarly, the central bank cannot ignore the presence of the Islamic bank and its activities. It pays heed to adjusting money supply and achieving stability as part of a goal to achieve economic and social development. And this cannot be realized without taking into account the role of existing Islamic banks, and recognizing their existence and role in economic life.

3.3 DEFINITION OF ISLAMIC CENTRAL BANK:

The Islamic central bank is similar in its functions, role and duties to the conventional central bank. However, the

---

1 Nasser, Al Gharib Mahmoud, *Banking control on Islamic banks*, Ph. D. Thesis presented at the Faculty of Commerce, Cairo (Egypt): Ein Shams University, 1991. pp. 133-137.

2 Kamel, Saleh Abdullah, *Islamic banking activities and the controlling role of central banks*, op. cit., p. 8.

basic difference lies in the fact that the Islamic central bank has standards and criteria from which it cannot deviate and which it cannot ignore. These criteria are based on Islamic laws. The Islamic central bank must fully comply Islamic laws. It cannot authorize dealing in usury any form. Contracts between the parties - whether between central banks and Islamic banks or between the Islamic banks themselves or between other parties - must be structured on Islamic laws without any compulsion or coercion.

Omar Shapera defines the Islamic central bank as an independent governmental institution responsible for the economic and social objectives of Islamic economy in the monetary and banking field.[1]

While others define Islamic central bank as 'an institution that occupies the top of the banking system, whose functions and activities are derived from the Islamic laws, and which manages the monetary policy of the country, playing economic and social role, controlling and saving other banks and issuing banknotes.'[2]

After reviewing various definitions of the Islamic central bank, the researcher has arrived at his own definition which suits its role, functions and nature. Therefore, the researcher defines the Islamic central bank as; an independent government institution within the framework of the country, at the top of the banking system, which devises and implements the monetary and credit policy of a country to achieve the economic and national objectives. It is also the last resort of all banks and financial institutions in the country. It is the bank of the government, and on it falls the responsibility of the religiously legitimate

---

1 Chapra, Mohammed Omar, *Towards a fair monetary system*, Translated by Sayyed Mohamed Sukkar, Herndon Virginia (U.S.A): The Islamic Thought International Institute, 1990 [2nd edition], p.196.

2 Ziauddin, Ahmed, and Others, *Fiscal policy and resource allocation in Islam*, Islamabad (Pakistan): Institute of Policy Studies, 1983, p.15.

control of all the operations carried out through it, and of all institutions operating under it.

Thus, the Islamic central bank has an important role in the economic and social life of any society or country. It stands as representative of the government. Therefore, it is a must for the government to select efficient, experienced, honest and skilled officials for the key jobs in the Islamic central ban. In return, the officials bear the task of designing and implementing the nation's financial and monetary policies. Since these policies have a bearing on all aspects of life and on all members of society, the officials in charge of the Islamic central ban should be honest and God-fearing. This aspect, both religious and ethical, is found exclusively in the Islamic economic system.

The Islamic central bank sits at the top of the banking system structure. Banks and financial institutions come under the purview of the Islamic central bank.[1] But there must be legislative control over the activities of the central bank and the operations of commercial banks and other Islamic banks. This authority must be completely independent and must have the expertise and power to undertake accurate auditing and research into any operations and transactions it would deem necessary.

3.4 THE CHARACTERISTICS OF THE ISLAMIC CENTRAL BANK:

The Islamic central bank has several exclusive characteristics:[2]

A. It sits at the top of the banking system. It is the supreme banking authority, and whose orders and instructions cover all banks and financial institutions.

---

1 Chapra, Mohammed Omer, *Money and Banking in an Islamic Economy*, a paper presented at the Makkah Seminar on Monetary and Fiscal Economics in Islam. Held on Makkah (Saudi Arabia): October 1978, p.9.

2 Al Tamimi, Yahya M. H., *Towards Islmic central bank*, M.A. Thesis, MakKah (Saudi Arabia): Islamic legislation faculity , Um Al Qura University, 1987, pp. 213- 227.

B. The functions of the Islamic central bank are the same as those the conventional central banks, and which agree with the Islamic Shariah. Those functions which conflict with Islamic laws must be modified in accordance with the teachings of Islamic legislation. If amendment fails, then an Islamically legitimate substitute has to be adopted.

C. The Islamic central bank has a crucial role in sifting out evil. Financial transactions, because of the sheer enormity of deals, are liable to commit forbidden mistakes. But when the central bank optimally plays its role in controlling these financial operations, it helps eliminate things which are forbidding.

D. The Islamic central bank is a control authority, whose task is to make sure of the viability of the instructions and operations of the central bank and the other banks. It has those authorities which enable it to ascertain the religious legitimacy of all transactions and deals which are concluded throughout the central bank or under its authority.

3.5 THE ECONOMIC OBJECTIVES OF THE ISLAMIC CENTRAL BANK:

Within the framework of the Islamic economic system, the monetary authorities represented by the Islamic central bank play an important role in achieving the overall objectives of Islamic economy. This role lies in achieving a well-balanced economic and social development by equal distribution of wealth amongst all members of society, and to endeavor for economic stability by cutting inflation and stabilising currency value. This is in addition to the achievement of the highest labor level. Accordingly, following are the objectives of the Islamic central bank:[1]

---

[1] Al-Homr, Abdel Malek *The role of the central bank within the framework of an Islamic banking system*, a research paper presented to the third conference of the Islamic bank, in cooperation with the International Union for Islamic Banks and Dubai Islamic Bank, held in Dubai, October 1985, pp.5-14.

A) THE ACIEVEMENT OF BALANCED ECONOMIC AND SOCIAL DEVELOPMENT:

The Islamic central bank assists in the implementation of the public economic policy of the country, the most important objective of which lies in the achievement of a balanced economic and social development. The balance lies in the development of various economic sectors in such a way that the growth is harmonious and integrated with each other so that the economy does not need imports except within limits. That is why it is a must to direct the available financial investments towards those projects which strive to achieve this goal. The central bank can study various projects proposed by the Islamic banks and grant approval to only those projects which can achieve the aspired objectives. If the aspired balanced economic development is achieved, its effects directly show upon all members of society.[1]

B) JUSTICE IN DISTRIBUTION OF INCOME AND WEALTH:

The Islamic central bank can achieve this objective by using the alms (zakat) funds which are transferred to it from the public treasury or from the Ministry of Finance. The Islamic central bank would work on the distribution of some of these funds through banks whose branches are spread all over the country to those who deserve alms (zakat). Some of these funds could also be used to set up projects with the aim of procuring job opportunities for the unemployed. The profit from these projects could be allocated either for expanding the outstanding projects with the aim of increasing job opportunities or for setting up new projects which would create more employment opportunities. Thus, the standard of living would go up.[2]

---

1 Ziauddin, Ahmed, and Others, *Fiscal policy and resource allocation in Islam*, op. cit., p. 59.

2 Kamel, Saleh Abdullah, *Islamic banking activities and the controlling role of central banks*, op. cit., p. 13.

The Islamic central bank can undertake studies which would enable the country to achieve the optimum use of these funds by directing investments towards projects in the poorest areas.

C) AN EFFECTIVE APPROPRIATION OF RESOURCES AND WORKING ON THE OPTIMUM USE OF THE AVAILABLE:

The Islamic central bank is in a position to direct the banks to invest in projects which aim at the optimum use of the available resources, because the exploitation of the natural resources cannot be done without necessary funds. Since the commercial banks have deposits, they can invest in projects which utilize the available resources.

D) THE ACHEIVEMENT OF THE STABILITY IN THE DOMESTIC AND FOREIGN VALUE OF CURRENCY, AND TO CUT INFLATION:

This is one of the most important objectives of the Islamic central bank. In its capacity as the issuer of money, it can affect the liquidity level, and consequently, stabilise currency value and price index. On the assumption that the banking system would remain subjected to the requirements of the legal reserve condition, the Islamic banks shall be able to expand credit and thus eventuate new cash. This new cash shall be invested in high profitable and successful projects, which shall accordingly result in an increase in the supply of commodities and services. But in the case of loss, the capital refunded to the bank shall be decreased by the amount of the loss. Consequently, there shall be shrinkage of the money supply. For within the framework of this system, it is unexpected that the money supply would exceed the commodities and services supply, which will protect the markets from any increasing or decreasing of prices.

E) THE ACHEIVEMENT OF THE HIGHEST LEVEL OF EMPLOYMENT:

This objective stems from the Islamic principle of social justice based on two important cornerstones: social security and social equilibrium. Islam considers Muslims as one nation. If one member suffers, all members feel the pain. So, Muslims must sustain each other. An Islamic country is responsible for creating job opportunities. This is more useful than doling out charity as it preserves the dignity of a person. Imam Muslim[1] reports a Hadith (sayings of the Prophet), in which the Prophet said: 'Whoever has left money, it shall be for his own kindness, and whoever has left a debt or estate that shall be for and on me'.[2]

The Prophet also said: 'Everyone is responsible for his subjects: the leader is responsible for his subjects, and the man is responsible for his family'.[3]

The Islamic government is responsible for securing the sufficiency level and not subsistence level for all its citizens. This can be done by providing job opportunities.

Thus, the central bank shall be able to achieve this objective by directing the banks' investments towards those projects which would result in absorbing the unemployed. The monetary policy laid down and implemented by the central bank aims at regulating liquidity, rationalizing credit policies and protecting national economy against different domestic and foreign influences, as well as securing the best and most suitable standard of living for all members of society.[4]

3.6 BANKING INTEREST AND USURY:

In capitalistic societies, the banking system relies on the interest rate. The interest rate policy is considered the

---

1 Imam Muslim is Muslim Ibn Hajaj Al Naisabouri, he is considered the second scholar of Hadith science (the saying of the prophet), and he collected a huge number of hadith and put them together in one book which became known Saheeh Muslim. He died in year 261 H.

2 El-Nawawi, Mohye El-Dine *Riyad Al-Saleheen, (The Gardens of the Good)*, Beirut (Libanon): Al-Ghazali Bookshop, 1982 p.105.

3 Ibid, p.146.

4 Ahmed, Mohye El Dine Ahmed, *The Role of the Central Bank in Relation to the Islamic Bank*, op.cit., p.13.

basic impetus of the elements of economic life under capitalistic system despite its negative effects and economic problems. Many economists have confessed that economy of a nation prospers when the interest is nil. The negative effects of interest are not merely confined to the economic facets of life, but also the social aspects by encouraging oppression, exploitation and enslavement of a certain category of people.

As for the danger of usury in relation to the economic life, Al-Razi mentioned in his book El-Tafseer El-Kabeer[1] by saying that: 'Usury has been banned as it prevents people from working for profits. For if the owner of the dirham could by way of the usury contract collect the extra dirham whether in cash or on deferred basis, earning his living would be easy for him, in such a way that he would not bear the hardships of gain, trade and hard and tiring manufacturing. That would lead to stopping the benefits of people. And it is well known that the benefits of the world would only be organized throughout trades, handicrafts, industries and constructions'.[2]

As for its danger in relation to social life, it disorients society and dilutes the social links built up on compassion, mercy, cooperation, love and charity. About that, El-Razi says: 'The reason for the banning of the usury contract lies in the fact that it leads to absence of gratitude between people because of the loan. For if usury is banned, then people would be happy to lend the dirham, and get back the same. But if usury is permitted and legalized, then the need of the needy would lead him to take the dirham for two,

---

1 El Razi is an islamic scholar, he was specialist in the science of Al Tafseer (Quran explanation) and became famous in this field, he died in year 606 h.
His book Al Tafseer Al Kabeer became an important reference in explanation of the holy Quran for all muslim scholars, students and researcher.

2 El-Razi, Al-Fakhr, *Al-Tafseer Al-Kabeer (The Major Explanation)*, Teheran (Iran): Scientific Books House, 2nd edition, Vol.7, 1981, p.94.

which would lead to the interruption of consolation, good deeds and charity'[1]. In addition to that, the interest would generate the feeling of oppressed in the society. This would generate hate and injustice between the poor and the rich people. To this effect, Ibn Taymiah[2] says: 'Usury is originally dealt with by the needy. Otherwise the wealthy would not take One Thousand at call or in cash for One Thousand and Two Hundred deferred if he shall have no need to own the One Thousand. Thereof, as a result of which that surplus would stand as being an oppression for the needy... which is the worst forms of oppression'[3].

Usury also enables the rich to control and dominate the poor by impounding their land or houses as guarantees against the loan. This would give rise to an economy built on slavery and subjugation. Islam is the religion of economic and social justice, and which calls for the elimination of exploitation. Islam respects the dignity of man and protects him from oppression and exploitation or abuse. It warned against usury and dealing with it as it is a source of illicit gain which leads to coercion, exploitation, oppression and abuse. From the Islamic jurisprudence, there is no difference between interest and usury. That is why, in this part of the research work, we shall deal with the subject of usury, clarifying its meaning, its kinds and the proofs which call for prohibiting it, and not using it in deals or in transactions, in addition to the relationship between interest and usury.

---

1 Ibid, p.94.

2 Ibn Taymiah, Ahmed, is an Islamic scholar; he was specialist in Islamic jurisprudence according to Hanbali school. He wrote many books about Islamic jurisprudence which became important references in Islamic jurisprudence for all muslim scholars, students and researchers. His book Al-Kawa'ed Al-Nouraniyya Al-Fikehiya is an Islamic jurisprudence reference in Hanbali school, it contains numerous of jurisprudence bases. He passed away in year 728 H.

3 Ibn Taymiya, Ahmed *Al-Kawa'ed Al-Nouraniyya Al-Fikehiya (The Enlightening and Canonic Rules)*. Edited by Mohamed Hamed Al-Fiqui, Cairo (Egypt): Mohammedan Sunnah Press, 1957, p.116.

3.6.1 THE DEFINITION OF USURY:

In Arabic language, riba (usury) literally means excess, augmentation, growth and addition. As for usury in Islamic law is an addition obtained in an unlawful manner. It is the increment which the lender imposes upon the borrower to pay in addition to the principal of the loan when the loan falls due or because of the extension in its duration.[1] While the Hanbali scholar Ibn Al Najjar defined usury as being: 'discrimination as to things, deferred as to things, and particular as to things, which legislation has banned and prohibited'.[2]

The definitions of usury in Islamic legislation differed according to Islamic sects. Yet, they all agreed in the one and same content which define usury as excess, this excess refers to two matters:

1) An extra benefit arising from unjustified increase in the weight or measure, and

2) An extra benefit arising from unjustified delay.

These two aspects have led our scholars to divide usury into two basic types:[3]

a) Riba Al-Fadl (excess of surplus or usury of increase)
b) Riba Al-Nasiah (excess of delay or deferred payment usury)

In the other meaning, Riba al-fadl refers to quantities, while Riba Al-Nasiah refers to time delay.

---

1 Ibn Manthour, Mohammed Ibn Makram *Lissan Al Arab*, op. cit., p.304.

2 Al-Futuhi, Mohamed Ibn Ahmad, (known as Ibn Al-Najjar), *Montaha Al-Iradat Fi Jame' Al-Mokne'a Ma'a Al-Tanquih Wal Ziyadat,* edited by Abdel Ghani Abdel Khalek, Cairo (Egypt): Al-Orouba Bookshop, Vol.1, 1961, p.375.
*** For more information about the religiously legitimate meaning of usury, refer to the book : *The Conversion of a Usurious Bank into an Islamic Bank*, by El-Rabi'ah, Saoud Mohamed, Kuwait: The Manuscripts, Heritage and Documents Centre, Vol.1, 1991, pp.30-35.

3 El-Rabi'ah, Seoud Mohamed, *The Conversion of the Usury Bank into an Islamic Bank*, op. cit., pp.30-35.

El-Jassass stated in his book, Ahkam Al-Quran[1] that; 'the usury which the Arabs were familiar with and which they practiced stood as being the lending of 'dirhams' and 'dananeers' to a certain maturity date with an increase over and above what was borrowed according to their agreement thereupon.' He adds: 'So God banned usury and also cancelled and prohibited other kinds of sale and called them usury. And hence we have Allah's command: (Allah has made trade lawful and usury forbidden), this means all forms of usury or interest were banned'.[2]

Similarly, the canonist Ibn El-Arabi[3], of the Malki school, made it clear that usury includes what was dealt in by the Arabs in their pre-Islamic age in usury, in addition to the other forms of sales which were banned and prohibited through the Prophet's Sunnah. He said: 'What is true is that it is general. For they used to sell and resort to usury in between them with usury being known to them. Man would sell to man up to a deferred maturity. If maturity fell due, he would ask, 'would you pay or resort to usury?' So God banned usury which is the increase or excess'.[4]

Ibn El-Arabi goes on explaining that usury includes that in which Arabs dealt during their pre-Islamic times, in addition to other forms of usury banned by the Prophet's Sunnah by saying: 'then God inspired it to the prophet to

---

1 El-Jassass, Abou Bakr Ahmed Ali, is an Islamic scholar, he was specialist in the Quran sciences (Holy Quran) and its explanation, he became famous in this field. He died in year 370 H. His book Ahkam Al Quran is an important reference in explanation of the holy Quran and its sciences.

2 El-Jassass, Abou Bakr Ahmed Ali, *Ahkamul Kora'an, (The Provisions of the Qoran)*, Cairo (Egypt): Al-Bahiyya Egyptian Press, Vol. 1, 1347 H., p.552.

3 Ibn Al Arabi, is Mohammed Ibn Abdullah, who is known as Ibn El Arabi, is an Islamic scholar; he was a specialist in Islamic jurisprudence according to Malki school. He wrote many books about Islamic jurisprudence and philosophy which became important references in Islamic jurisprudence. Ibn Al Arabi died in year 543 H.

4 Ibn Abdullah, Mohamed, (known as Ibn El Arabi), *Ahkam Al-Qura'an*, edited by Ali Mohamed Al-Bejawi, Cairo (Egypt): The Arabic Books Revival House, Vol.1, 1957 [1st. edition], p. 241.

put it down to them in addition of what they practiced in terms of contract or indemnification impermissible to them by putting down to them the banned and prohibited facets of usury in each falsehood and the price of things in surplus'.[1]

El-Nawawi also mentioned in his book El-Majmouh Sharh El Mohathab, On behalf of El-Mawardi, he said:[2] '... El-Mawardi said: "our companions differed in relation to what has been stated in the Quran, in terms of the prohibition of usury in two aspects:

a. That it is a comprehensive term explained by the Sunnah, and that the provisions stipulated upon by the Sunnah stand as being a clarification for the Quran.
b. That the Quranic prohibition tackled what was in practice in pre-Islamic times in terms of the deferred payment usury, and the request for an increase in money with the increase of the maturity date. Then came the Sunnah, by adding usury in cash'.

After studying the opinions of the Muslim canonists, we come to the conclusion that usury prohibited and banned by Islamic Shariah is the pre-Islam usury practiced by the pre-Islam Arabs in addition to other kinds which stood as being the usury on trade. Muslim canonists mentioned that whether in trade or debt, usury takes place. Any increase in the value of the loan against allowing an extension in the repayment period is considered usury. Furthermore, the trade operations have interferences of usury in several forms and

---

1 Ibid, pp.242-243.

2 El-Nawawi, Mohye El-Dine Ibn Sharaf Al-Majmou' *Sharh Al-Mohathab, (The Collection of the Explanation of the Educator)*, Cairo (Egypt): Published by Zakarya Ali Youssef, 1970, p.442.
(The book of Al majmou' Sharh Al Mohathab, is an explanation to A Mohathab book, which is a book that specialist in Islamic jurisprudence according to Shfie' school. The writer of this book is Mohy El Dien Al Nawawi, a brief about him was stated in a previous part of this research work.

various kinds as shall be clarified when reviewing the kinds of usury.

3.6.2 THE KINDS OF USURY:

Contemporary Muslim experts have divided usury into two basic parts.[1] - The deferred payment usury or the pre-Islam usury which was banned by the holy Quran. The second one is the usury on trade. This has two categories: delayed (nasi'ah) and stipulated excess (tafadul).

Muslim canonists had different opinions as to the kinds of usury. But the contemporary Muslim scholars unanimously agree with their predecessors who looked at usury comprehensively. Thus, they divided usury into two parts which are the debts usury and the trade usury.[2] Sheikh Mohamed Abou Zahra[3] says, when dividing usury by describing the first part as being the pre-Islamic usury which is the debts usury. In this usury, a debt is increased with extension in maturity date. The increase is against extension, and this increase is the usury which has been banned and prohibited by the Quran. About the second part of usury, he describes it as being the trade usury.

Below are some details about these two kinds of usury: Riba Al-Fadl (excess of surplus) and Riba Al-Nasiah (excess of delay).

---

1 The Muslim canonists had different approaches to the indication of the sorts of usury. They differed as to the method of dividing usury. Some of them divided it into three kinds, and some others into two kinds. Yet the divisions of the Islamic scientists and researchers in modern times have determined two parts for usury one of which is in debts, which is the deferred usury, and another in sales, which is also known as the preference usury .

2 Al-Mawdoudi, Aboul Aala *Usury (Al-Reba)*, Arabicized by:Mohamed Assem El-Haddad, Damascus (Syria): Dar El Fiker Al Islami, 1958 [1st. edition], p.122.

3 Abou Zahrah, Mohamed, *Khatamu'l Nabiyyeen (The Last of the Prophets)*, Cairo (Egypt): Dar El Fiker Al Arabi, 1973, pp.66-67.

(1) THE DEFERRED PAYMENT USURY:

The deferred payment usury is also known as the debt usury and the pre-Islamic usury. It is the usury which was banned and prohibited by the Glorious Quran: 'Believers, do not devour usury in doubles and multiples, and fear Allah so that you may prosper'.[1]

Another verse says: 'Allah has made trade lawful and usury forbidden'.[2]

And the Prophet's saying as recounted by Muslim: 'The Jaheleyah 'Pre-Islam' usury is laid aside, and the first usury set aside is our usury, being the usury of El-Abbas Ibn Abdel Mottaleb, for it is laid down or set aside in full'.[3]

The debts usury takes one of the two following forms:

a) It is an excess in time (a delay) artificially added to the transaction. It is an unjustified delay. This refers to the possession ('ayn) and its non-possession (dayn) of the medium of payment. For example, so-and-so would borrow from another person a certain amount of money on the understanding that he would repay it at a fixed time and on a determined date. If the borrower fails to repay the loan on time, then an agreement is reached to defer the maturity date of the repayment of the debt against an increase in the value of the loan which the borrower will have to repay to the lender together with the initial value of the loan. This is the first form of pre-Islamic usury, wherein the usurer relates the principal loan to the element of time. Each and every extension of time is faced by an increase in the repaid or refunded money. If the loan is in cash, the quantity would be multiplied by repayment time. But if it is

---

1 *The holy Quran*, verse of Al-Omran, section 130.

2 *The holy Quran*, verse of Al-Baquarah, section 275.

3 Muslim Ibn Hajaj Al-Nissapuri, *Sahih Muslim (The Authentic Muslim)*, explanation by: Yehya Ibn Sharaf Al-Nawawi, Cairo (Egypt): The Egyptian Press and its Bookshop, Vol.2, 1969, p.45.

in kind such as animals, then the debt would be moved from the age determined to the age which is older and subsequent.

El-Tabari[1] said: 'The pre-Islamic usury is when a man sells the item sold up to a fixed maturity. If repayment fails in the stipulated time, it shall then be increased with a deferment thereof ...'[2] .El Tabari also said: 'Zeid Ibn Islam, said: "Usury in pre-Islamic times is the multiplication with age. A man may have the upper hand of a debt, and when its respective maturity date falls due, he would say to him: you settle me or pay me or you increase the debt. If the debtor has something to pay, then he would pay, otherwise he would refer the debt to the age stage which is over and above that in case the debt is a kind of animal". If parturition, he would render it milch in the second year, then a mane (a camel beginning the age of four), then a young camel at the age of five, then a quadruple, and so on, moving upwards ... As for the case in kind (silver and gold), if the debtor has not got what to pay with, the creditor would double the debt in the following year. In case he hasn't got it, he would further double it. If it is one hundred, he would make it two hundred, with a double thereof every year if he hasn't got what to repay the debt with'.[3]

b: The increase on the loan in the core the contract: This was the second form of usury in the pre-Islamic times

---

1 El Tabari, Mohammed bin Jarir, is an Islamic scholar, he was specialist in the Quran sciences (Holy Quran) and its explanation in addition to the science of Hadith, he became famous in these fields. He died in year 310 H. He wrote many books such as Tafseer Al Tabari (Al Tabari interpreting), Tareekh Al Tabari (Altabari History), and Jame'e Al-Bayan Fi Ta'weel Al-Quor'an (The Collection of Statements as to the Interpretation of the Koran) which considered one of the most famous books that explain the holy Quran.

2 El-Tabari, Mohammed, Ibn Jareer, *Jame'e Al-Bayan Fi Ta'weel Al-Quor'an (The Collection of Statements as to the Interpretation of the Koran)*, Beirut (Lebanon): Dar Al-Maaref, Vol.7, 1980, p.207.

3 Ibid, p.207.

wherein borrowing took place against determining a preconditioned increase fixed at the inception of the contract and paid with the loan at a fixed time. It is a financial increase over and above the principal of the loan, stipulated upon as a precondition in the core or body of the contract when it is signed, and which is payable in a monthly or annual form, or in a one lump sum. This has been determined by El-Jassass in his book Ahkam Al-Quran wherein he said that: 'usury which the Arabs knew and practiced is that of lending dirhams and dananeers to a certain maturity date with an excess over and above what was borrowed as agreed upon by them'.[1]

Similarly, Al-Fakhr Al-Razi mentioned this form in his book Al-Tafseer Al-Kabeer by saying that: 'the deferred payment usury is the one which was agreed upon in practice during the pre-Islamic times. For they used to pay the money provided that they would collect every month a determined amount with the capital remaining intact. On the maturity date of the debt, they would ask the debtor to repay the capital. If he cannot do that they would increase both the right and the maturity date, and this is the usury transacted during pre-Islamic days'.[2] From our review of the second form of the pre-Islamic usury, it becomes clear that it is the one which is similar to the usurious interest paid by banks to depositors or which borrowers from banks repay to banks, which is an overt usury prohibited by Islamic Shariah.

(2) THE SALE USURY:

This kind of usury was unknown to Arabs in pre-Islamic times as being usury. For although they dealt in it prior to the advent of Islam, yet they did not call it by the name of

---

1 El-Jassass, Abou Bakr Ahmed Ali, *Ahkam Al-Quor'an (The Provisions of the Koran)*, op. cit., p.465.

2 El-Razi, Al-Fakhr, *Al Tafseer Al-Kabeer, (The Major Interpretation)*, op. cit., p.85.

usury.[1] It is the usury which was banned in the Prophet's Sunnah and Hadith. This kind of usury is in either one of two forms, which are:

A. EXCESS OF SURPLUS USURY:

This is the usury realised when something is sold against something of the same kind, together with the increase of one of the two substitutes over and above the other. For example, one gramme of barley would be sold by one person to another person against two grammes or more of barley, that is to say for an amount which is over and above or less than the amount which he had sold. For as long as the substance sold of one kind or species would have its value repaid out of a similar material or substance, that is to say from the same kind or species, this requires that the barter or exchange would be effected at a fixed amount or quantity with one party increasing or decreasing the value. This does not only apply to barley, but to other kinds determined by the Prophet in six items, with other similar kinds following suit.

B. THE SALE ON CREDIT USURY:

This is the usury that is realized when something is sold against its own kind or species, with the encashment of one of the two substitutes being postponed or deferred. For example, a person would sell one gramme of wheat to another person against another gramme of wheat provided the exchange would take place at more than one session. If the exchange takes place at one session hand by hand, then there would be no usury in this case. But if one of the two parties would delay the delivery of the value of one of the two substitutes, then this would be banned and prohibited usury.

It ensues to us from our reviewing the sale usury, that two fundamental terms and conditions must be realized to negate

---

1 El-Jassass, Abou Bakr Ahmed Ali, *Ahkam Al-Kor'an (The Provisions of the Koran)*, op. cit., p. 552.

usury when exchanging one kind or species with another of the same kind or species. These two terms and conditions are:

(a) Similarity in amount or quantity, and:

(b) settlement and encashment at the contract council or session.

As for the exchange of one good with another such as gold with silver or wheat against barley, exchange or barter must be done hand by hand without delay to avoid usury.

The excess of surplus usury and the sale on credit usury has been subject of a number of the Hadith. Muslim recounted on behalf of Abi Said El-Khidri[1]: 'The Prophet said, "Gold for gold, and silver for silver, and wheat for wheat, and barley for barley, and dry dates for dry dates, and salt by salt, one equal for equal, hand by hand, and whoever increased or asked for an increase will have fallen in usury, the taker and giver being the same therein'.[2]

And also what was recounted by Al-Bokhari[3] and Muslim on behalf of Abi Said El-Khidri that the Prophet said: 'Do not sell gold for gold except through one equal for another equal, and do not increase some over some, and do not sell silver for silver except for an equal for equal without increasing some over some, and do not sell thereof what is distant by what is present or actual'.[4]

---

1 Al Khedri, Abi Saeed is a follower to the profit Mohamed. He narrated a huge number of hadiths from the profit.

2 Muslim Ibn Hajaj Al-Nissapuri, *Saheeh Muslim (The Authentic Muslim)*, Vol.11, op. cit., p.14.

3 Imam Al Bukhari is Abu Abdullah Mohammed ibn Ismaeel, he is considered the first scholar in the science of Hadith, and he collected a huge number of hadith and put them together in one book which became known Saheeh Bukhari. He died in year 256 H.

4 An agreed upon Prophet's saying. See :
Al-Bokhari, Mohamed Ibn Ismail, *Saheeh Al-Bukhari (The Authentic Bokhari)*, Beirut (Lebanon): Dar El-Fikr, Vol.3, 1981, p.30. and,
Muslim, Ibn Hajaj Al-Nissapuri *Saheeh Muslim (The Authentic Muslim)*, Vol.11, op. cit, p.11.

His saying: do not increase some over some, means do not prefer some over some. As for his saying: do not sell thereof what is distant by what is present or actual means do not sell present for deferred.

On behalf of Abi Said El Khidri, he said: 'We used to be bestowed upon by the assemblage of dry dates, which stands for the mixture of dry dates. And we used to sell two measures of capacity for one measure of capacity. So, the Prophet, said: 'No two capacity measures for one, and no two dirhams for one'.[1]

For the glorious Prophet prohibited us by means of the previous Hadith from exchanging the two measures by one and the two dirhams by one in order to stop falling into the trap of banned usury. On behalf of Abi Said El-Khidri, he said: 'Belal came to me with Berni dry dates.[2] So, the Prophet, blessed he be by God, said to him 'Where did you get this from?' Belal said: 'We had a bad kind of dry dates. So, I sold two capacity measures of it for one, in order to feed. So the Prophet said, 'Oh! Oh! This is real usury. The real usury. Don't do. But if you wanted to buy. Sell first the dry dates, then buy with that'.[3]

There are several other Hadiths which prohibit usury or dealing in it in any form. However, we consider those we have mentioned as being sufficient to prove the prohibition.

3.6.3 RELATIONSHIP BETWEEN BANKING INTEREST AND USURY:

Interests, in all kinds and forms, are nothing but overt usury banned by Islam. From the religious standpoint, there is no difference between usury - which stands as being each

---

1 Al-Bukhari, Mohamed Ibn Ismail, *Saheeh Al Bukhari (The Authentic Bukhari)*, Vol.3, op. cit., p.10. and, Muslim, Ibn Hajaj Al-Nissapuri, *Saheeh Muslim (The Authentic Muslim)*, Vol.11, op.cit., p.23.

2 Al-Barni dates is one of the good kinds of dry dates.

3 Al-Bukhari, Mohamed Ibn Ismail, *Saheeh Al-Bukhari (The Authentic Bukhari)*, Vol.3, op. cit., p.64. Muslim, Ibn Hajaj Al-Nissapuri, Saheeh Muslim (The Authentic Muslim), Vol.11, op. cit., p.23.

and every loan which drew benefit - and between the interest rate collected by the lender from the borrower, since in each of interest and usury, there is a precondition for the increase of a percentage over and above the capital, with this rate being determined according to the consideration of the element of time. The difference between interest and usury is in names only. But despite different names both are the same. It must be borne in mind that Islamic teachings are based on intents and meanings and not wordings and structures.

In order to confirm that the interest, whether banking or non-banking, is prohibited usury, we must clarify the meaning of interest or the interest rate and have that reviewed in the light of the Quranic verses, the Prophet's Hadiths, and the canonic opinions which ban and prohibit usury.

Interest, in its common economic concept, is the price paid against the use of money. In other words, it is the cash price for the use of a cash amount. Economists have defined the interest as being the price paid by the borrower as against the use of the lender's money. Usually, this price is expressed by the form of a percentage rate per annum. That is why it is called the interest rate.[1]

The deposits - whether for a fixed maturity or the savings one - undertaken by individuals are nothing but lending to banks. It has been stated in Egyptian Code - Article 726 - that if the deposit is an amount of money or any other thing which is depreciated by utilization and the depositary was

---

1 El Rabi'ah, Saud Mohamed, *The Conversion of the Usury Bank into an Islamic Bank,* Vol.1, op. cit., p.58. and see,
Ghattas, Nabeeh, *The Glossary of Expressions of Economy,Money and Business Administration,* Beirut (Lebanon): Librairie du Liban, 1985 [1st. edition], p.295. and,
Omar, Hussein, *The Encyclopaedia of Economic Expressions,* Cairo (Egypt): The Modern Cairo Bookshop, 1967, p.208.

authorized to use it then the contract shall be considered a loan.[1]

El-Sanhouri gave examples of the loan contract as the depositing of money in a bank. The customer who has deposited the money is the lender, and the bank is the borrower.[2] When a person deposits money in a bank, he lends the bank a certain amount of money for a certain period of time. Upon the expiry of this period of time, he shall have the right to retrieve his money in addition to surplus amounts paid by the bank to the customer against the bank's use of the lender's funds. This surplus money is at present called the banking interest. Furthermore, when any person borrows an amount of money from any bank, he shall have to repay the principal of the loan in addition to surplus amounts against his use of these funds for a certain period of time. These surplus amounts are also called banking interest.

From the foregoing, it ensues that a deposit is nothing but a loan to a banks. The bank here is the borrower, and the customer being the lender. If we would recapitulate on what we have previously said about usury, its parts and kinds, we would clearly discern the relationship of the banking interest with usury. On basis of the foregoing, any increase payable over and above the capital upon payment becomes usury prohibited by Islam.

Pre-Islamic usury, as known by pre-Islamic Arabs, and as prohibited by the Glorious Quran, is exactly what is named, in our times, the interest. Abou Zahra said that the pre-

---

1 The General Authority of Civil and Commercial Articles, and the Civil Circuit, and the Circuit of Personal Status, *The Collection of the Civil Cassation Verdicts,* Cairo (Egypt): The sub-press of the Supreme Court, the year 16, 1966, issue 3 (from October to December 1965), p.975. and see, El-Sanhouri, Abdel Razak Ahmed, *Al-Wasseet Fi Sharh Al Quanoon Al-Madani Al-Mesri (Al-Wasset in the interpretation of the Egyptian Civil Code)*, Cairo (Egypt): Dar Ehya'a Al Turath Al-Arabi, V.25, 1987, p.429.

2 Al-Sanhouri, Abdel Razak Ahmed, op. cit., p.435.

Islamic usury, which is the debts usury, is by lending a debt and increasing the debt whenever there is an extension in repayment maturity date. For the increase is against deferment, and this increase is usury, which has been prohibited and banned by the Quranic verses.[1]

After having reviewed the purpose and meanings of interest and usury, we understand that any increase over and above the principal amount and which is encashed by the bank's customer in case of the bank's borrowing from its customers by accepting and taking in their deposits or when the bank lends loans to its customers out of its own funds, or from its deposits, is but overtly banned usury. It is one of the forms of pre-Islamic usury prohibited by the Glorious Quran. Therefore the pre-Islamic usury was exactly what is known at present as the banking interest, with no difference between them except in as far as naming is concerned. Since usury is banned in Islam, the banking interest is banned for Muslims.

The Muslim scholars have unanimously agreed that the banking interest is a banned usury which may not be dealt in. They considered this an unquestionable issue in view of the clarity of its prohibition and the matching of its principle with the pre-Islamic usury.

Unfortunately, despite the unanimity of Muslim scholars, there is still a minority relying on interpretations, utterances and weak pretext not approved nor admitted by the Muslim scholars.

3.7 CREDIT FACILITIES IN ISLAMIC BANKS:

The Islamic banks employ several methods for completing their investment and finance transactions. These investment and finance methods are known as the Islamic Credit Facilities. These methods are different from those used at

---

[1] Abi Zahrah, Mohamed, *Khatem Al-Nabeyeen (The Last of the Prophets)*, op. cit., p.66.

the traditional banks, which work on the basis of banking interest. The basis of the investment and finance transactions at Islamic banks is the principle of partnership between two parties, the first party is the bank and the other party is the client who receives the fund from the bank.

The Islamic investment and finance methods were used in the past in the Islamic communities. These methods were developed and updated. They have been introduced into the prevailing banking systems. Of these investment and finance methods are the speculations (Mudarabah), partnerships (Musharakah), trading (Murabaha), leasing transactions (Ijarah), and others. These methods as employed by the Islamic banks in its investment and finance transactions are diversified. Each method has its advantages, flaws, and activities with which such method is exclusively concerned. The Islamic banks may employ these investment and finance methods with their different customers or in their existing investment and finance relations with other banks and the central bank.

The central bank, through the Islamic finance and investment methods, can play its role in the implementation of different monetary policies within the boundaries of the country. These methods enable it to pump part of its funds to the Islamic banks that need these funds whether for facing the demands of their clients and depositors or facilitating their dealings with third parties. Also, the Islamic banks deposit their monetary surplus and the other cash requirements that it imposed on them by the central bank like the legal reserve by resorting to the same methods of Islamic investment and finance. The central bank also determines to the Islamic banks from time to time a distribution of the economic activities in the country and sets a statement of the Islamic finance and investment methods convenient to each activity.[1]

In this part of the research, the researcher will shed light on the most important methods for investment and finance employed at Islamic banks. The methods for investment and finance at the Islamic banks are divided in the following kinds:[2]

a) Modes of profit sharing: This comprises speculation (Mudarabah) and crop sharing (Muzara'a).
b) Modes of partnership: This comprises permanent partnership and decreasing partnership.
c) Modes of trading: This comprises Murabaha transactions, forward delivery transactions (Salam), and manufacturing transactions (Istisna'a).
d) Modes of Lease Transactions: They comprise operational lease and purchasing lease transactions.

There are also other methods for investment and finance used in Islamic banks to a lesser extent such as installment sale and direct investments. The following table indicates the investment and finance methods employed in the Islamic banking sector during the period between 2000 and 2002, as percentages of the total.[3]

---

1 Al Tamimi, Yahya, *Towards Islmic central Bank,* op. cit., pp. 215- 219.

2 Khoja, Ezzedine Mohammed, *Instruments of Islamic Investment,* Jeddah (Saudi Arabia): Publications of Dallah Al Baraka Group, 1995, pp. 7-9.

3 Source: Global Islamic Banking Statistics, *Islamic Finance directory 2004,* Manama (Bahrain): Published by General Council for Islamic Banks and financial Institutions, 2004, p.7.

Table No 3.1

Islamic Modes for Investment and Finance That Applied in the Global Islamic banking Sector

Description	Year 2000		Year 2001		Year 2002	
	%	(US$ 000)	%	(US$ 000)	%	(US$ 000)
Murabaha	19.7%	20,499,039	26.45%	49,641,236	15.27%	15,918,097
Musharakah	4.2%	4,388,773	7.96%	14,944,316	0.97%	1,010,933
Mudarabah	3.7%	3,882,458	6.35%	11,926,557	1.55%	1,612,764
Leasing	1.3%	1,400,140	1.13%	2,120,972	1.72%	1,792,360
Istisn'a	1.1%	1,130,465	0.89%	1,679,543	1.41%	1,465,422
Salam	1.8%	1,820,576	3.41%	6,407,977	0.29%	303,465
Others	35.2%	36,550,400	48.32%	90,700,392	26.06%	27,167,006
Direct Investments	33.0%	34,241,596	5.48%	10,283,924	52.74%	54,972,693
Total Investments and Financings	100%	103,913,447	100%	187,704,917	100%	104,242,740

Before entering into detailed explanation of these methods, we must explain here that the central bank in any Islamic country has a major role in determining the proper transactions and methods for granting banking facilities for each economic activity separately. The central banks impose on all banks, operating under their jurisdiction, laws determining the kind of methods proper for each economic activity. We find this clear in the central bank of Pakistan's circular whereby the Pakistani banks are obliged to employ these methods.[1] This is also quite clear in the laws issued by the central bank of Iran for the Iranian banks.[2]

Therefore, we notice from the following table No.3.2 a statement of the general economic activities in Iran, and a

---

1 Central Bank of Pakistan, Banking Control Department, Circular No. 13, Issued on June 20, 1984 and its Annexes I & II.

2 Central Bank of Iran, Law for Usury Free Banking, Tehran (Iran), August 1983.

similar statement of the investment and finance methods proper for these economic activities, in order to extend the banking facilities through them to these sectors.[1]

Table No. 3.2

Methods of Financing Operations in Iran

Types of Activity	Permissible Methods
Productive: Industrial Mining Agriculture	Installment sales, Civil partnership, Legal partnership, Hire purchase, Forward delivery transaction, Direct investment, Qard hassan, Muzarah, Mosaqat, and Jo'alah.
Commercial: Imports Exports Domestic	Mudarabah, Civil partnership, Legal partnership, and Jo'alah.
Services	Installment sales, Civil partnership, Legal partnership, Hire purchase, and Jo'alah.
Housing: Construction Repairs	Installment sales, Civil partnership, Legal partnership, Hire purchase, Direct investment, Qard hassan, and Jo'alah.
Personal needs	Qard hassan

Given below is a detailed explanation of each kind of the methods of finance and investment employed at the Islamic banks.

3.7.1 PROFIT SHARING TRANSACTIONS:

Profit sharing is a contract between two parties in which one party provides capital to the other party who undertakes the management in exchange of a share in the output. The most important steps of these operations are:

a. Only one party provides capital whether it is money (Mudarabah contract) or a piece of land (Muzara'a) or fruit trees (Musaqah).

[1] Sudin Haron & Shanmugam, Bala, *Islamic Banking System: Concepts & Applications*, Selngor Darul Ehsan (Malaysia): Pelanduk Publications, 1997, p. 113.

b. The other party undertakes the management and disposal of capital, where the right of ownership and the right of disposal are separate.

c. In case the project suffers loss, the capital owner only bears this loss, whereas the two parties share the output when the final result is profit (after the capital owner recovers his capital).

d. The operation continues up to the conclusion of the deal.

MODES OF PROFIT SHARING:

Profit sharing operations include different kinds of contracts such as Mudarabah, Muzara'a, Musaqah, Mugharasah and others. Following are an explanation of the modes of Mudarabah and Muzara'a transactions.

MUDARABAH TRANSACTIONS:

Speculation (Mudarabah) is a partnership between two parties in which one party provides the money to the other to invest or operate, provided the profit shall be distributed between the two parties as agreed between them, provided the share of each one shall be common and known in profit sharing such as one half or one third of the profit. Speculation is considered the only form of investment known in ancient Arab civilization, and then it was approved by Islam later on the basis of dual agreement between the fund owner and its operator, whether they are individuals or groups. It is the largest Islamic method of investment. It is the basis on which many of the Islamic bank transactions are centred.

DEFINITION OF MUDARABAH:

Mudarabah in essence is based on the concurrence of those who have capital with those who have expertise, where the first party provides capital and the other party provides the expertise with the purpose of earning profit which will be divided between them in ratios agreed upon. This mode achieves the interest of both parties, the capital owner and the agent (Mudarib), wherein the capital owner may not have the time or the experience to invest the capital and trade with it, and the agent may not have the adequate capital to put to use his experience.

Muslim economists have defined the term 'speculation' in several ways. Some define it as being 'a partnership in the profit in which the capital is provided by one party and its operation is handled by the other party providing each one's shares is common and known part of the profits agreed upon beforehand on signing the contract.'[1]

Ibn Abdin defined it as: 'a contract of partnership in the profit, with a fund from one party and operation by another'[2], in the sense that speculation is only a partnership between two parties, one party extending the fund and the other providing the operation and investment of that fund, providing the yield shall be distributed between the two parties in proportions agreed upon by them.

Muhammad Taqi Usmani has defined Mudarabah as: 'a special kind of partnership when one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner who is called the capital owner, while the management and work is an exclusive responsibility of the other, who is called Mudarib'.[3]

From the above definitions we come to know that Mudarabah transaction is a contract when the owner of the capital gives it to a worker or manager to trade on their behalf, and profits are shared according to an agreed-upon formula. All financial losses are borne by the capital provider,

---

1 Al-Baaly, Abdel-Hamid Mahmoud, *Basics of the Islamic banking transactions: Reality & the future*, Cairo (Egypt): Wahba's Library, 1990, P. 68.

2 Ibn Abdin, Mohamed Amin Ibn Omar, *Ibn Abdin's margin, rad al-mehtar ala Al-dor Al-mokhtar, sharh tanweer al-ebsar*, Cairo (Egypt): Mostafa Al-Halabi Printing House, Vol.5, 1966, P. 645.

3 Usmani, Muhammad Taqi, *An introduction to Islamic Finance*, Karachi (Pakistan): Idaratul Ma'arif, 1998, P.47.

while the worker or manager can only lose his efforts if no profits are made.

TYPES OF MUDARABAH:

There are two types of Mudarabah:[1]

A. Restricted Mudarabah: In this case the capital owner may specify a particular business for the agent (Mudarib).

B. Unrestricted Mudarabah: In this case the capital owner gives the agent (Mudarib) a cretin amount of money, authorizing him to invest it in any business he deems fit.

AREAS OF APPLICATION OF MUDARABAH:

Mudarabah is considered to be one of the essential modes accredited by the Islamic banks in their relationship with the depositors who tender their moneys to the bank as capital owners to be invested by the bank as Mudarib on the basis of profit sharing according to specific ratios agreed upon.

The Islamic banks use the same mode with the investors. The bank provides the adequate finance as a capital owner in exchange of a share in the profit to be agreed upon. It is worth noting that this is a high-risk mode for the bank because it delivers capital to the agent (Mudarib) who undertakes the work and management and the Mudarib shall only be a guarantor in case of negligence and trespass. The Islamic banks usually take the necessary precautions to curtail the risk and to guarantee a better execution for the Mudarabah and pursue this objective with seriousness.

Speculation (Mudarabah) is employed at Islamic banks as a method of Islamic investment and finance, where it represents a low percentage of the total facilities extended by the Islamic banking sector. It is noticed from the

---

1 Al Fudailat, Jabr Mahmoud, *Financial Transactions in Islamic legislation,* Amman (Jordan): Published by Arab Acadimy for Financial and banking Sciences, Vol. 1, 1999, p.339.

previous table No. 3.1 that the speculation transactions represented 3.7% of the total banking facilities extended by the global Islamic banking sector in 2000. This percentage rose in 2001 to the limits of 6.35%, and then returned to fall thereafter until reaching the levels of 1.55% in year 2002.[1]

As a practical example of the importance of employing the speculation method at Islamic banks, and the percentage it represented from the total granted credit facilities, we provide here a statement of the value and percentage of Mudarabah transactions from the total investment and finance transactions carried out at a selective Islamic countries[2] for the years 2001 and 2002:[3]

Table No 3.3

Table showing the value and percentage of Mudarabah transactions carried out at selective Islamic countries

(Value in million $US)

Description	Saudi Arabia		Bahrain		Iran	
Year	2001	2002	2001	2002	2001	2002
Total Investment & Financing Transactions	12,890,581	14,100,517	2,443,747	2,499,128	145,359,060	55,365,426
Mudarabah Transactions	00	00	323,756	370,313	11,085,952	312,539
Percentage of Mudarabah to Total	0.00%	0.00%	13.25%	14.82%	7.63%	0.56%

1 See table No. 3.1, page 80 Of this research work.

2 The researcher has selected Saudi Arabia, Bahrain and Iran as a sample of Islamic countries that Islamic banks are practiced there. And the resone for selecting these countries out of the other remaining Islamic countries is their importance of these countries as central financial centers in the region, and their experience in the practicing of the Islamic banking.

3 The source is: *Islamic Finance Directory 2004*, op. cit., pp.135, 161, and 220.

As it is seen from the above table that the Mudarabah transactions in Bahrain were representing a medium percentage in year 2001 and 2002 comparing to the total investment and finance transactions, while in Iran it was in the low level in year 2002 and a reasonable level in year 2001, but in Saudi Arabia there was no Mudarabah transactions in year 2001 and 2002.

(2) MUZARA'A TRANSACTIONS:

Muzara'a transaction is a partnership in agriculture wherein one party provides the land and the other party undertakes the farming. Under the category of Muzara'a, there are two additional transactions that have the same characteristics and conditions, these two transactions are Musaqah and Mugharasah[1].

Musaqah refers legally to the landlord giving a worker access to his farm to maintain it and water it, with an agreement between the two parties to share the produce of the trees according to an agreed upon ratio at the end of the contract[2]. While Mugharasah is a contract whereby a landlord gives a worker access to his land to plant tress therein, and the two parties will share the ownership of the trees and its produce[3].

DEFINITION OF MUZARA'A:

Muzara'a (crop sharing) is to give the land to whoever can cultivate it or work in it in exchange of a share in the crop. This transaction achieves the interests of parties, the landowner and the agent. The landowner may not be able

---

1 Musaqah and Mugharasah are literally derived from Arabic words saqa which mains to water, and gharasah which means to plant.

2 Zuhayli, Wahbah, *Financial Transactions in Islamic Jurisprudence,* Damascus (Syria): Dar Al Fiker, Vol. 2, 2003, P537.

3 Ibid, P.559.

to cultivate the land or work in it, and the other side the agent may not have the land he needs.

Wahbah Zuhayli has defined Muzara'a as 'an investment contract involving agricultural land. The two parties to the contract are the landlord and the farmer (worker). The contract specifies that crop is to be shared between the parties according to agreed upon shares.'[1]

FORMS OF MUZARA'A:

There are two forms for Muzara'a as regards which party supplies the seeds and machinery, the two parties may agree on that:

A. The landowner supplies the seeds and the machinery and becomes the employer of the worker who works on the land in exchange of some of the produce. The aim of this contract in this case is the work of the agent.
B. The agent supplies the seeds and the machinery and becomes a tenant in exchange of some of the produce. The aim of this contract in this case is the benefit of the land.

3.7.2 PARTNERSHIP OPERATIONS (MUSHARAKAH):

Musharakah is a word of Arabic origin which literally means partnership or sharing. In the context of business and trade, it means a joint enterprise in which all the partners share the profit or loss of the joint venture. Musharakah is an ideal alternative for interest-based financing with far reaching effects on both production and distribution.

The method of finance by partnership is based on the principle of shouldering the individual with burdens equal to the privileges and rights he obtains, such that the two parties become even. This leads to realizing justice in

---

1 Ibid, P.521.

distribution and equal opportunities in work, as well as partnership in economic activity[1]. Therefore, a big percentage of financing the work and projects that takes place at the Islamic banks is performed through the method of partnership where the financing bank contributes to the profits and losses of the project benefiting from the finance. This type of finance distributes the yield fairly between the financier and the project owner.

DEFINITION OF MUSHARAKAH (PARTNERSHIP):

Muslim scholars define the 'partnership' as being a contract between two or more persons on establishing a commercial, industrial or agricultural project with the aim of realizing a profit[2]. In a more general and comprehensive range, Al-Baaly defined the partnership as participation, by virtue of a contract, between two or more parties in assuming an investment project according to the aims of Islamic law, in which they share with their funds, work or high standing, providing the profit shall be distributed among them as they stipulated on signing their contract[3].

We find that the partnership operation means two or more parties draw a contract to work together by the capital they contribute in condition of dividing the accruing profit.

The most important traits of these operations are:

A. Participation in capital whether the capital is money, labour or liability.

B. Partnership in management and disposal, wherein the right of ownership and disposal remains to each partners.

C. Partnership in the result of the operations whether profit or loss.

---

1 Mashhour, Amira Abdel-Latif, *Investment in the Islamic Economy,* Cairo (Egypt): Madbouli bookshop, 1991, P. 261.

2 Zoheili, Wahba, *the Contemporary Financial Dealings*, Damascus (Syria): Al-Fekr House, 2002, P. 431.

3 Al-Baaly, Abdel-Hamid Mahmoud, *Basics of the Islamic Banking Transactions; Reality & the future*, op. cit, P. 114.

TYPES OF MUSHARAKAH:

There are two types of partnerships which are applied by the Islamic banks. These two types are the permanent partnership and decreasing partnership.

(1) PERMANENT PARTNERSHIP:

This mode of partnership is represented in the contribution of the partners to equal or unequal ratios of capital to establish a new project or to participate in an established one, whereby each participant owns a share in the capital permanently and deserves his share of the profit. The partnership originally is intended to continue up to the dissolution of the company, but it is possible for the partners to sell his share in the capital to withdraw from the project.

The Islamic banks use the mode of partnership in many projects. They finance their customers with part of the capital in exchange of a share of the output as they may agree upon. They also mostly leave the responsibility of management to the customer-partner and retain the right of supervision and follow up.

AREAS OF APPLICATION OF THE PERMANENT PARTNERSHIP:

The Islamic banks employ the permanent partnership operations in many of their investment and finance transactions and in granting their banking facilities, where the Islamic banks enter as a partner in some investment or finance transactions that have a defined time limit commensurate with the plans and aims of the Islamic bank providing the finance. The central banks in some Islamic countries prescribed in their by-laws the necessity of employing the partnership method in certain economic activities along with imposing that method on all Islamic banks operating under their supervision. We, therefore, notice that the central bank of Iran recommends the Iranian banks to employ the method of partnership in the productive, industrial, commercial, service, and housing activities[1]. The same applies to the central bank of Pakistan which determines the fields of activities that may be financed through partnership in the Pakistani banks operations as these activities were specified in the commercial, industrial, and agricultural fields[2]. Also, in following up the transactions of several Islamic banks, we find that they employ the method of partnership in their finance facilities. It is noticed in the table No.3.1 that the method of partnership represented at 4.2% of the total facilities extended by the global Islamic banking sector in 2000, and it rose to 7.96% in year 2001, then it dropped to the level 0.97% of the total facilities of the global Islamic banking sector in year 2002.[3]

We provide here a statement of the value and percentage of Musharakah transactions from the total investment and finance transactions carried out at select Islamic countries[4] for the years 2001 and 2002:[5]

---

1 Central Bank of Iran, Law for Usury Free Banking, Tehran (Iran), August 1983.

2 Central Bank of Pakistan, Banking Control Department, Circular No. 13, Issued on June 20, 1984 and its annexes I & II.

3 Refer to table No 3.1 P.80 of this research work.

4 The reason for selecting these countries as a sample for Islamic countries is stated in page 87 of this research work.

5 The source is: *Islamic Finance Directory 2004*, op. cit., pp.135, 161, and 220.

Table No 3.4

Table showing the value and percentage of Musharakah transactions carried out at a selective Islamic countries for the years 2001 and 2002

(Value in million $US)

Description	Saudi Arabia		Bahrain		Iran	
Year	2001	2002	2001	2002	2001	2002
Total Investment & Financing Transactions	12,890,581	14,100,517	2,443,747	2,499,128	145,359,060	55,365,426
Musharakah Transactions	12,729	0.0	65,039	83,058	14,201,744	245,504
Percentage of Musharakah to Total	0.10%	0.00%	2.29%	3.32%	9.77%	0.44%

From the above table it becomes evident that Musharakah transactions in Saudi Arabia, Bahrain and Iran were representing a low percentage in year 2001 and 2002 compared to the total investment and finance transactions except in 2001 in Iran when the Musharakah transaction represented a level of 9.77% which is a reasonable level. Therefore, we find that the method of partnership is considered to be the appropriate mode for collective investment in modern economic life. The Islamic banks use partnership by contributing capital to new or established projects. They also bear part of the cost of a project equal to the ratios of their shares in capital. The Islamic banks by using partnership as a mode of investment make sufficient liquidity available to the customer in the long run. The Islamic banks are usually active partners; they participate in determining the methods of production and the objectives of the establishment. They also supervise and follow up the performance of the establishment. The Islamic banks share profit or loss with the (partners) customer without burdening the customer with debt and financial liabilities which it has to pay in all circumstances.

(2) DECREASING PARTNERSHIP:

Decreasing partnership is a mode innovated by the Islamic banks. It differs from the permanent partnership only in continuity. The Islamic bank in this mode has all the rights and obligation of the ordinary partner. The Islamic bank from the very beginning does not intend to stay in and continue the partnership up to the liquidation of the company. Instead the Islamic bank gives the other partner the right to take the place of the bank in the ownership of the project and agrees to assign its share in the partnership to the customer for full payment at one and the same time or gradual non-imbursement, in accordance with conditions agreed upon. In reality, there are many forms for the application of the decreasing partnership. The most widely used form is the form in which the bank gradually relinquishes its share to the partner; in exchange the partner pays the price to the bank periodically (from the return of the project or external sources) during a reasonable period to be agreed upon. After the discharge the bank withdraws from the project and it becomes the property of the partner.[1]

AREAS OF APPLICATION OF THE DECREASING PARTNERSHIP:

The decreasing partnership is suitable for the finance of industrial establishments, farms, hospitals and every project capable of producing regular income. Nowadays it is considered to be the appropriate mode to finance collective investment. As regards the bank, it earns periodic profit all the year round, and as regards the partner, it encourages the partner to participate in halal (approved) investment. It realises the customer's ambition to

---

1 Khoja, Ezzedine Mohammed, *Instruments of Islamic Investment*, Jeddah (Saudi Arabia): Publications of Dallah Al Baraka Group, 1995, p.101.

individually own the project in the short run when the bank withdraws gradually. As regards the society, it corrects the course of the economy by developing the mode of positive partnership instead of the negative relationship of indebtedness. By doing so it achieves equity in distributing the results.

3.7.3 TRADING TRANSACTIONS:

Trading means the operations of buying with the intention of selling through the turnover of capital to make halal profit from the difference between the sale price and purchase cost.

MODES OF TRADING:

Trading operations include the different types of sales in Islam. The jurists have divided these into four with respect to the items of exchange, the commodity and the price, which can be real or cash. The four divisions are:[1]

a. Exchange sale (Almuqayadah sale): This is the sale of asset for asset or the exchange of one for another.
b. The currency exchange (Sarf): This is the sale of price for price, or the exchange of money for money.
c. The general sale (Al mutlaq sale): This is the sale of an asset for a price. It can be: for immediate cash then it is a spot sale. Or, for a deferred price then it is sale on credit.
d. The sale of a price for an asset. It is a transaction in which the price is paid cash but the delivery of goods is deferred to a specific period of time. In this kind of sale the price can be paid entirely and immediately at drawing the contract. In this case it is called salam sale. Or, in installments or deferred. In this case it is called Istisna'a sale.

---

1 Zuhayli, Wahbah, *Financial Transactions in Islamic Jurisprudence,* Damascus (Syria): Dar Al Fiker, vol. 1, 2003, p.235.

(1) MURABAHA SALE OPERATIONS:

Murabaha sale transaction means a cost plus sale, which is selling the commodity for the purchase price plus a certain profit margin agreed. This margin can be a percentage of the purchase price or a lump sum. Most of the Islamic banks and financial institutions are using Murabaha as an Islamic mode of financing. It is employed by the Islamic banks as one of the most important Islamic finance and investment operations. It thus enables the bank to employ its savings through using them in financing the clients' different requirements and purchases, and at the same time it enables the clients to obtain from the bank the finance they need for purchasing the commodity or service they want.

DEFINITION OF MURABAHA:

Murabaha is known as selling the commodity at its purchase price along with adding a determined profit to the purchase price.[1]

In such method, the seller mentions to the buyer the price by which the commodity is bought and stipulates for him a determined profit on selling it to him. Muhammad Taqi Usmani defines the Murabaha operation[2]: 'It is a particular kind of sale where the seller expressly mentions the cost of the sold commodity he has incurred and sells it to anther person by adding some profit or mark up thereon'. Therefore, Murabaha is not a loan given on interest, but it is a sale of a commodity by adding some profit to the purchase price.

TYPES OF MURABAHA:

Murabaha sale is divided into two types:

---

1 Al-Jezeiri, Abdul-Rahman, *Al fiqeh ala al mathaheb al arba'a (Jurisprudence according to the four schools)*, Cairo (Egypt): The Greater Commercial Bookshop, Vol.2, 1970, p.278.

2 Usmani, Muhammad Taqi, *an Introduction to Islamic Finance*, op. cit., P. 103.

a) Ordinary Murabaha Sale: In this type there are two parties in the transaction, the seller and the buyer. The seller is an ordinary trader who buys a commodity without depending on a prior promise of purchase, and then he displays it for Murabaha sale for a price and a profit to be agreed upon.

b) Murabaha sale connected with a promise: In this type there are three parties in the transaction, the seller, the buyer and the bank as intermediary trader between the buyer and the seller. The bank here does not purchase the commodity or the service unless the buyer specifies his desire and a prior outstanding promise from the buyer to purchase is done. The mode of Murabaha sale connected to a promise is used by Islamic banks which undertake the purchase of commodities according to the specifications requested by the customer and then resell them on Murabaha to the one who promised to buy for its cost price plus a margin of profit agreed upon previously by the two parties.

AREAS OF APPLICATION OF MURABAHA:

Murabaha is one of the most widely used modes of finance by the Islamic banks. It is suitable for partial financing to the investment activities of the customers, in industry, trade or other. It enables the customer (investor) to obtain finished goods, raw material, machines or equipment from the local market or through import. Islamic banks employ the Murabaha operation in many of their investment and finance transactions and in granting the banking facilities, where this method is frequently used at the Islamic banks because of its easy application. The central banks in some Islamic countries prescribed in their by-laws the necessity of employing the Murabaha method in certain economic activities along with imposing that method on all Islamic banks operating under their supervision. We, therefore, notice that the central bank of Pakistan determined the fields of activities that may be financed through the Murabaha method in the operations of Pakistani banks where it determined these activities in the commercial, industrial, housing and agricultural fields.[1]

In following up the transactions of several Islamic banks, we find that they frequently employed the method of Murabaha in their finance facilities. It is noted from the aforementioned table No.3.1 that the method of Murabaha represent a level 19.7% of the total facilities of the global Islamic banking sector in year 2000, this level rose to 26.45% in year 2001, then it decreased to 15.27% of the total facilities of the global Islamic banking sector in year 2002.[2]

As a practical example of the importance of employing the Murabaha method at Islamic banks, and the percentage it represented from the total granted credit facilities, we provide here a statement of the value and percentage of Murabaha transactions from the total investment and finance transactions carried out at a selecte Islamic countries[3] for the years 2001 and 2002:[4]

1 Central Bank of Pakistan, Banking Control Department, Circular No. 13, Issued on June 20, 1984 and its Annexes I & II.

2 Refer to table No 3.1 P.80 in this research work.

3 The researcher has selected Saudi Arabia, Bahrain and Iran as a sample of Islamic countries that Islamic banks are practiced there.

4 The source is: Islamic Finance Directory 2004, op. cit., pp.135, 161, and 220.

Table No 3.5

Table showing the value and percentage of Murabaha transactions carried out at selective Islamic countries

(Value in million $US)

Description	Saudi Arabia		Bahrain		Iran	
Year	2001	2002	2001	2002	2001	2002
Total Investment & Financing Transactions	12,890,581	14,100,517	2,443,747	2,499,128	145,359,060	55,365,426
Murabaha Transactions	184,751	156,634	1,230,132	1,147,897	35,597,443	529,828
Percentage of Murabaha to Total	1.43%	1.11%	50.34%	45.93%	24.49%	0.96%

As it is seen from the above table that the Murabaha transactions in Bahrain were representing a high percentage in year 2001 and 2002 compared to the total investment and finance transactions, while in Iran it was in the low level in year 2002 and in a high level in year 2001, but in Saudi Arabia there was a very law level of Murabaha transactions in year 2001 and 2002.

(2) SALAM SALE TRANSACTIONS:

Salam sale transaction is a sale of a commodity with deferred delivery for a cash price. This is a financial transaction in which price is made in advance in cash to the seller who abides by the delivery of commodity of determined specification on a definite date.

The Salam sale serves the interests of the customer and the financing bank. It serves the interest of the customer, as a seller, who gets money in advance in exchange of his obligation to deliver the commodity later. He benefits from the Salam sale by covering his financial needs. In the other side it serve the financing bank, which acts as the purchaser, since the bank gets the commodity it is planning to trade on the time it decides. The commodity becomes the liability of the seller. The bank also benefits from the cheap price, because usually Salam sale is cheaper than a cash sale. This way the bank is secured against price fluctuations. The bank can sell on parallel Salam commodity in the same kind as it has previously purchased on first Salam without making one contract depend on the other. The bank also has the option of waiting to receive the commodity and then sell it for cash or deferred payment.

DEFINITION OF SALAM:

Salam sale is called forward delivery transaction. It is a sale whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advanced price fully paid on the spot.[1] In this case the price is cash, but the supply of the purchased goods is deferred.

Wahbah Al Zuhayli has defined Salam as: 'It is a sale of deferred item in exchange for an immediate price'.[2] In the other words, it is the sale of a liability whose characteristics are described in exchange for a price paid in advance. The basic purpose of this sale is to meet the needs of the small farmers who needed money to grow their crops and to feed their family up to the time of harvest.

Similarly, the traders used to export goods to other places and to import some other goods to their homeland. They needed money to undertake this type of business, therefore, they sell the goods in advance and after receiving their cash price, they could easily purchase the needed goods.

AREAS OF APPLICATIONS OF SALAM TRANSACTIONS:

The Islamic banks employ the deferred delivery method (Salam) in some of their investment and finance operations

---

1 Usmani, Muhammad Taqi, *An introduction to Islamic finance*, Op. cit., p.186.

2 Zuhayli, Wahbah, *Financial Transactions in Islamic Jurisprudence*, vol.1, op. cit., p.238.

and in granting the banking facilities. The central banks in some Islamic countries prescribed in their laws the necessity of employing the deferred delivery method in certain economic activities and imposed that method on all Islamic banks operating under their supervision. We, therefore, notice that the central bank of Iran advised the Iranian banks to employ the deferred delivery method in the productive activities, whether industrial or agriculture.[1]

We also find that the deferred delivery method is used at the Islamic banks, where it is noticed in the aforementioned table No.3.1 that the method (Salam) was at level equal to 1.8% of the total facilities extended by the global Islamic banking sector in year 2000, then this percentage was rose to 3.41% in year 2000, and it decreased to level 0.29% of the total facilities for the global Islamic banking sector in 2002.[2]

As a practical example of the importance of employing the Salam sale method in Islamic banks and the percentage it represented from the total granted credit facilities, we provide here a statement of the value and percentage of Salam sale transactions from the total investment and finance transactions carried out at a selective Islamic countries[3] for the years 2001 and 2002:[4]

---

1 Central Bank of Iran, Law for Usury Free banking, Tehran (Iran), August 1983.

2 Refer to table No.3.1, P. 80 of this research paper.

3 The researcher has selected Saudi Arabia, Bahrain and Iran as a sample of Islamic countries that Islamic banks are practiced there.

4 The source is: *Islamic Finance Directory 2004*, op. cit., pp.135, 161, and 220.

Table No 3.6

Table showing the value and percentage of Salam sale transactions carried out in selective Islamic countries

(Value in million $US)

Description / Year	Saudi Arabia		Bahrain		Iran	
	2001	2002	2001	2002	2001	2002
Total Investment & Financing Transactions	12,890,581	14,100,517	2,443,747	2,499,128	145,359,060	55,365,426
Salam Sale Transactions	0.0	0.0	64,751	7,050	6,308,767	226,935
Percentage of Salam to Total	0.0%	0.0%	2.65%	0.28%	4.34%	0.41%

We, therefore, find that the Salam sale method could be used by Islamic banks in the following fields:

a) Salam sale is suitable for the finance of agricultural operations, where the bank can transact with farmers who are expected to have the commodity in plenty during harvest either from their own crops or crops of others, which they can buy and delivery in case their crops fail. Thus the bank renders great services to the farmers in their way to achieve their production targets.

b) Salam sale is also used to finance the commercial and industrial activities, especially phases prior to production and export of commodities and that is by purchasing it on Salam and marketing them for lucrative prices.

c) The Salam sale is applied by the bank in financing craftsmen and small producers by supplying them with the inputs of production as a Salam capital in exchange of some of their commodities to remarket.

d) The Salam sale has the advantage of the needs of various sectors of people industrialists, contractors or traders finance of operation costs and capital

(3) MANUFACTURING TRANSACTIONS (ISTISNA'A):

The manufacturing method is considered one of the most important investment and finance methods employed by Islamic banks in granting the credit facilities for some industrial activities and for the building and contracting activities. The majority of the jurists consider Istisna'a as one of the divisions of Salam. Therefore it is subsumed under the definition of Salam. But some other jurists make Istisna'a as an independent and distinct contract.[1]

The Islamic banks can utilize Istisna'a in two ways:

a) it is permissible for the bank to buy a commodity on Istisna'a contract then sell it after receipt for cash installed or deferred price.

b) It is also permissible for bank to enter into Istisna'a contract in the capacity of seller to those who demand a purchase of a particular commodity and then draw a parallel Istisna'a contract in the capacity of a buyer with another party to make manufacture the commodity agreed upon in the first contract.

DEFINIATION OF ISTISNA'A:

The jurists use the term of Istisna'a to refer to the request of manufacturing a specific item in a specific form. Therefore, the jurists have given various definitions of Istisna'a, some of which are: 'that it is a contract with a manufacturer'[2] and 'it is a contract on a commodity on

---

1 Khoja, Ezzedine Mohammed, *Instruments of Islamic Investment*, Op. cit., p.49.

2 Al Fudailat, Jabr Mahmoud, *The Financial Transaction in Islamic Legislation*, op. cit., p. 120.

liability with the provision of work'.[1] Some other jurists have defined Istisna'a as: 'a contract commissioning a worker to manufacture an item that is defined as a liability on him'.[2]

Thus Istisna'a is a contract to purchase the item to be manufactured by the worker, where the worker provides both the raw material as well as the labor to produce the final product specified in the contract.

From the above-mentioned definitions we come to know that Istisna'a combines two distinctive traits:

a. The distinctive trait of Salam is its permissibility even though the subject of the contract does not exist at the time of contract.

b. The distinctive trait of the ordinary absolute sale whereby the price is not necessarily paid in advance as in Salam. Because Istisna'a involves labor beside the materials, it becomes akin to the leasing (Ijarah) in which deferment of payment is permissible.

AREAS OF APPLICATION OF ISTISNA'A TRANSACTIONS:

The manufacturing method (Istisna'a) is used by the Islamic banks in several economic fields such as industry, contracting works, and building businesses. However, it is noticed that the manufacturing method usually represents a low percentage of the total credit facilities granted by the Islamic banks. It is noticed in the aforementioned table No.3.1 that the manufacturing method (Istisna'a) was ranged between 1.1% of the total facilities granted by the Islamic banking sector in year 2000, then this percentage was decreased to 0.89% in year 2001, to achieve 1.41% in year 2002.[3]

---

1 Khoja, Ezzedine Mohammed, *Instruments of Islamic Investment*, op. cit., p.49.

2 Zuhayli, Wahbah, *Financial Transactions in Islamic Jurisprudence*, vol.1, op. cit., p.268.

3 Refer to table No.3.1, P. 80 of this research paper.

The Islamic banks employ the manufacturing method in some of their investment and finance transactions, and in granting the banking facilities. The banking regulation of central banks in some Islamic countries comprise directions for necessarily employing the manufacturing sale method in certain industrial, contracting, and building activities, and imposed it on all the Islamic banks operating under their supervision.

As a practical example of the importance of employing the Istisna'a method at Islamic banks, and the percentage it represented from the total granted credit facilities, we provide hereinafter a statement of the value and percentage of Istisna'a transactions from the total investment and finance transactions carried out at a selective Islamic countries[1] for the years 2001 and 2002:[2]

Table No 3.7

Table showing the value and percentage of Istisna'a transactions carried out at selective Islamic countries

(Value in million $US)

Description	Saudi Arabia		Bahrain		Iran	
Year	2001	2002	2001	2002	2001	2002
Total Investment & Financing Transactions	12,890,581	14,100,517	2,443,747	2,499,128	145,359,060	55,365,426
Istisna'a Transactions	1,314,389	1,147,674	28,404	53,100	0.0	0.0
Percentage of Istisna'a to Total	10.20%	8.14%	1.16%	2.12%	0.0%	0.0%

1 The researcher has selected Saudi Arabia, Bahrain and Iran as a sample of Islamic countries that Islamic banks are practiced there.

2 The source is: *Islamic Finance Directory 2004*, op. cit., pp.135, 161, and 220.

Therefore, we find that the manufacturing method (Istisna'a) can be employed at the Islamic banks in the following fields:

a) Istisna'a contract opens wide fields of application for the Islamic Banks to finance the public needs and the vital interests of the society to develop the Islamic economy.

b) Istisna'a contract is applied in high technology industries such as aircraft industry, locomotive and ship building industries, in addition to the different types of machines produced in the big factories or workshops.

c) The Istisna'a contract is also applied in the construction industry such as apartment buildings, hospitals, schools, universities to whatever that makes the network of modern life.

d) Istisna'a contract is applicable to the various industries as long as one can be monitored by measurement and specifications such as the food processing industry.

(4) SALE ON CREDIT:

The sale on credit is based on the delivery of the commodity by the seller to the buyer and enabling it to possess and benefit from the commodity, with the understanding that the buyer will pay the agreed upon price at a certain future date. Usually the deferred price is higher than the cash price. This sale is divided into two kinds:

a) Deferred payment, which is paying the price entirely at the end of a specific period.

b) Installment Sale, which is paying the price in determined installments at specific periods of time agreed upon by the parties.

AREAS OF APPLICATION OF SALE ON CREDIT IN ISLAMIC BANKS:

The Islamic banks employ the term sales operations in many of their investment and finance transactions and in granting the banking facilities, where the Islamic banks purchase a specified commodity or asset in favor of one of their clients with determined conditions, then term-sell it at a price exceeding the purchasing price. The deferred settlement may be made altogether at a determined time, or in installments. The central banks in some Islamic countries prescribed in their legislations the necessity of employing the method of sale by installments in certain economic activities, and imposed that method on all Islamic banks operating under their supervision. We, therefore, notice that the central bank of Iran recommended the Iranian banks to employ the method of partnership in the productive, industrial, commercial, agricultural, service, and housing activities.[1]

The same applies with regard to the central bank of Pakistan which determined the fields of activities that may be financed through the method of sale by installments in some transactions of Pakistani banks, where it determined these activities in the commercial, industrial, and agricultural fields.[2] Also, in following up the transactions of several Islamic banks, we find that they employ the method of sale by installments in their finance facilities. It is noticed in the foregoing table No.3.1 that the method of sale on credit was within the 'other methods' item which represented at a percentage of 35.2%, 48.32% and 26.06% in the years 2000, 2001, and 2002 respectively of the total facilities that granted by the Islamic banking sector.[3] We, therefore,

---

1 Central Bank of Iran, Law for Usury Free banking, Tehran (Iran), August 1983.

2 Central Bank of Pakistan, Banking Control Department, Circular No. 13, Issued on June 20, 1984 and its Annexes I & II.

3 Refer to table No.3.1, P. 80 of this research work

find that the method of sale on credit is employed at the Islamic banks as follows:

a) People used the sale on credit in the past and are presently using it. In most countries it is more extensively used than the cash sale.

b) The sale on credit facilitates transactions between people. It benefits both the seller and the buyer. The seller will get a higher price and the buyer gets the item sold before paying all the price.

c) The Islamic Banks use the sale on credit to finance many a customer. They purchase the commodity paying cash and then sell it to desirous customers for a deferred price or in installments agreed upon.

d) The sale on credit is used mostly to finance expensive consumer goods such as furniture, cars and household appliances. It is also used to finance housing and capital goods such as machines and equipment.

3.7.4 LEASING TRANSACTIONS (IJARAH):

Lease is the employment of money in operations other than sale and purchase operations. That is the subject if the operation is the sale of the benefit of the asset not the asset itself. These operations aim at obtaining the rentals and the proceeds by receiving the benefits of the asset through time. The most important traits of lease operations are as follows:

a) They basically enable the lessee to possess and use the assets it needs without pumping large amounts of money.

b) Lease operations do not transfer the ownership of the assets; they only transfer the ownership of the benefits.

c) Profit is independent from the corresponding value of the asset it is a rental that accrues from the renewal of benefit.

DEFINITION OF LEASING (IJARAH):

Ijarah is Arabic word which means Leasing. Leasing is a contract whereby the owner of something transfers its usufruct to another person for an agreed period, at an agreed consideration.[1] Some other writers has defined Ijarah as: 'an Islamic concept of leasing finance, whereby the bank purchase that asset required by the customer, and then lease the asset to the customer for a given period. The lease, rental, and other terms and conditions have to be agreed upon by both parties'.[2]

LEASING TRANSACTION IN THE ISLAMIC BANKS:

The Islamic banks employ the lease method in many of their investment and finance transactions and in granting the banking facilities. The central banks in some Islamic countries prescribed the necessity of employing the lease method in some economic activities and imposed on all Islamic banks operating under their supervision to employ the lease method in these economic activities. Therefore, the central bank of Pakistan determined the fields of activities that may be financed through the lease method in the transactions of the Pakistani banks, where it determined these activities in the commercial, investment, industrial, and agricultural fields.[3] Also, many Islamic banks employ the lease method in their finance facilities. It is noticed in the foregoing table No.3.1 that the lease method represents a percentage equal to 1.3% of the total facilities extended by the global Islamic banking sector in 2000, then in years 2001 and 2002 the lease transaction represented a level of 1.13% and 1.72% respectively of the total facilities extended by the global Islamic banking

---

1 Usmani, Muhammad Taqi, *An introduction to Islamic finance*, Op. cit., P.159.

2 Sudin Haron & Shanmugam, Bala, *Islamic Banking System: Concepts & Applications*, op. cit., P.80.

3 Central Bank of Pakistan, Banking Control Department, Circular No. 13, Issued on June 20, 1984 and its Annexes I & II.

sector.[1] The Islamic Banks use the lease for the benefits as an instrument of financing. They purchase possessions and fixed assets to let, where the assets are put at the disposal of the customer to utilize in return of rental. The Islamic banks use two modes of Ijarah, these modes are:[2]

a) Operational Leasing.

b) Lease to Purchase.

(1) OPERATIONAL LEASE:

The operational lease is considered as one of the investment and finance methods employed at the Islamic banks, since it realized for the Islamic banks high degrees of safety they wish for in their different finance and investment transactions. It also represents for them an outlet through which they can respond to the needs of their clients in providing the finance suitable for them. Through that method, the Islamic bank possesses specific assets, machines, or realties for which there is an important need from certain categories of the society, in order to lease them to its clients for a determined period of time, and then they return to the bank which subsequently looks for a new lessee to whom the bank leases them for another period of time.

No doubt the operational lease realizes the interest of both parties: the bank and the client. The bank's interest is realized through finding proper investment and finance channels with low risks allowing for the bank to employ part of its property, funds and savings. The transaction also realized the interest of the bank's client who substitutes the big capital spending operations for purchase of assets, machines or realties by leasing them instead of buying them with enormous amounts.

---

1 Refer to table No.3.1, P.80 of this research work.

2 Khoja, Ezzedine Mohammed, *Instruments of Islamic Investment*, op. cit., p.60.

DEFINITION OF OPERATIONAL LEASE:

According to this mode the Islamic Bank maintains a number of various assets to respond to the needs of different customers. These assets usually have a high degree of marketability. The bank lets these assets to any party so desirous to utilize for a term to be agreed upon. After the termination of the lease period the assets return to the bank, on its part the bank looks for a new lessee. The distinguishing feature of this mode is that the assets remain the property of the Islamic bank to put them up for rent every time the lease period terminates so as not to remain unutilized for long periods of time. Under this mode the bank bears the risk of recession or diminishing demand for these assets.

The operational lease divides into two kinds:

a) Specific or determined lease: It is the lease of real property or other assets that one can point to.

b) Lease described on liability: It is the Lease of benefit determined by specifications agreed upon to be on liability such as a car or a ship, not particular but precisely described to forbid dispute.

AREAS OF APPLICATION OF OPERATIONAL LEASE TRANSACTIONS:

The Islamic banks employ the operational lease transactions in financing some transactions related to certain important assets such as the aircraft, ships, and fleets of trucks and trailers. They also employ them in financing some realties and buildings, in addition to leasing some equipment and machines whether industrial or agricultural, or in the field of contracting. The operation lease transactions are suitable for high cost expensive assets, that demand large amounts of money in order to possess, in addition to the long time necessary for its production. The Islamic banks can carry business in the line of operation lease in many assets such as industrial equipment and agricultural machinery as well as the means of transportation. All these can satisfy the immediate needs of different parties. The Islamic banks benefit from this mode of financing since it retains the assets in its possession and at the same time receives returns from leasing. The lessee also benefits by covering its immediate demand and achieving its objectives at the appropriate time without bearing large capital cost.

(2) LEASE PURCHASE:

Lease purchase financing or Ijarah waiktina refers to a contract where the bank purchases an asset for the purpose of renting the same to the customer against an agreed rental together with the client's agreement to make payments which will eventually lead to the transfer of ownership from bank to customer.[1]

DEFINITION OF LEASE PURCHASE:

The lease purchase or lease that ends with possession is a new mode innovated by the Islamic Banks. What distinguishes this sort of transaction is that the bank does not maintain the assets depending on market studies to ascertain the existence of a demand for them, but purchases the asset as a response to an emphatic request from one of the customers to own the asset through lease that ends with possession. Therefore the asset will not remain the property of the bank at the end of the lease period as the case in the operation leases but the ownership transfers to the lessee. The bank mostly calculates the total rental on the basis of the cost of assets plus the profit, and then the rental is installed in periods to be agreed on.

In practice there are two basic forms through which the asset becomes the property of the lessee at the end of the lease period.[2] The first form is a lease contract with a

---

1 Sudin Haron & Shanmugam, Bala, *Islamic Banking System: Concepts & Applications*, op. cit., P.80.

2 Khoja, Ezzedine Mohammed, *Instruments of Islamic Investment*, Op. cit., P.75.

promise to grant the asset to the lessee after paying the entire rental installment. The grant must be in a separate contract. Wherein, the second form is a lease contract with a promise to sell the asset to the lessee in exchange of a nominal or actual price, the lessee pays at the end of the lease period after paying all the rental installments agreed upon.

AREAS OF APPLICATION OF THE LEASE PURCHASE OPERATIONS:

The lease method ending with ownership is frequently employed at the Islamic banks as it realizes the interests of the client and the bank. It realizes the client's interest by enabling him to acquire the assets or commodities he wishes to obtain and giving him possession thereof based on the lease installments settled by him, which represent in their totality the value with which the bank purchases these assets or commodities plus the profit margin he accepts. This method also realizes the bank's interest through investing part of its funds and deposits in an investment and finance operation yielding a suitable profit, and at the same time representing low risks since the ownership of the asset remains in the name of the bank throughout the lease period pending settlement of the total lease value by the client. The Islamic banks use the lease with option to purchase specially in real estate, computer sets, machinery and equipment. By so doing the Islamic banks give the customers a degree of freedom of choice to have the assets they need from the sources they select in the light of their experience and personal evaluation. The lessee in this case enjoys the possession and use of the asset through the lease period and it is certain that ownership of the asset will be transferred to it at the end of the lease period. The bank also, retains the ownership of the asset and it assigns it to the lessee only after the payment of the rental installments agreed upon.

3.7.5 OTHER INVESTMENT AND FINANCE OPERATIONS:

In addition to the investment and finance methods explained above, the Islamic banks usually resort to using additional methods such as direct investment or some kinds of interest-free loans (Quard Hassan). The portion of direct investment at the Islamic banks represents a significant percentage of the total investment and finance operations due to the nature of work of the Islamic banks that are concerned with the investment aspects and with entering directly in productive projects. Direct investment by Islamic banks is either in the form of direct contributions to some of the companies and projects realizing the targets of the bank, or in the form of purchasing listed shares of companies for the purpose of realizing investment profits for a determined period of time. It is noticed in the foregoing table No.3.1 that the method of direct investments was representing a very high level. It represented 33.0% of the total facilities that granted by the global Islamic banking sector in year 2000. This percentage was decreased in year 2001 to 5.48%, thin it was increased significantly to the level of 52.74% in year 2002.[1] As a practical example of the importance of employing the direct investments in Islamic banks, and the percentage it represented from the total granted credit facilities, we provide hereinafter a statement of the value and percentage of direct investment transactions from the total investment and finance transactions carried out at select Islamic countries for the years 2001 and 2002:[2]

---

[1] Refer to table No.3.1, P. 80 of this research work.

[2] Source is: *Islamic Finance Directory 2004*, op. cit., pp.135, 161, and 220.

Table No 3.8

Table showing the value and percentage of Direct Investments transactions carried out at selective Islamic countries

(Value in million US$)

Description	Saudi Arabia		Bahrain		Iran	
Year	2001	2002	2001	2002	2001	2002
Total Investment & Financing Transactions	12,890,581	14,100,517	2,443,747	2,499,128	145,359,060	55,365,426
Direct Investment Transactions	961,597	958,911	87	1	16,666,032	47,017,522
Percentage of Direct Investments to Total	7.46%	6.80%	0.004%	0.0%	11.47%	84.92%

Furthermore, the Islamic banks usually resort to employing another kind of investment methods, namely the method of investment in commodities, which is used in investing the short-term liquidity or the so-called current account deposits. It should be mentioned here that some of the direct investment operations usually taking place at the Islamic banks might have a finance basis, where the Islamic bank resorts, in certain cases, to financing some operations of its distinguished clients through the direct investment method, in which the Islamic bank participates, for a period of time, in the projects submitted by the client who requires finance therefore, and when the performance of these projects improves and they realize a good level of revenues, the bank sells its share in those investments to its partners in those projects. Thus, the Islamic bank realizes by this method its profit aim through extending the required finance, and, at the same time, it realizes the client's interest represented in his pressing need for the provision of finance for his investment project.

CONCLUSION:

The discussion in this chapter is focused on many subjects related to the reasons call for setting up Islamic central banks. We dealt at the beginning of this chapter with the operation environment of the Islamic banks. It was noticed in this regard that the relationship between Islamic banks and central banks is governed by three methods. The first method involves the countries which have converted their banking system in full into the Islamic system. The second involves the countries which have authorised the setting up of Islamic banks beside the conventional banks. The monetary authority in these countries have constituted a separate Islamic banking law for the Islamic banks which is different from the conventional banking law. The third method involves the countries which set up Islamic banks under special laws so that these banks would work under conventional central banks which supervise them, monitor their activities and regulate or organise their relationships and transactions exactly the same way as the conventional banks.

We also discussed the reasons for establishing Islamic central bank. We came to know that the Islamic banks have expanded and spread out in several countries, and that the instruments used by the conventional central bank in supervising and controlling and following up the conventional commercial banks are unfit for Islamic banks. The other important reason for creating an Islamic bank is that the Islamic banks are in need of a certain entity, within the boundaries of the country, which would support and back them, while providing them with whatever services and support they need.

The definition of Islamic central bank, which comprises the characteristics of these banks, was incorporated in this chapter. It was concluded that the Islamic central bank has several characteristics. It is that entity which heads the banking system and has the functions and instruments that agree with the teachings of Islamic Shariah. It has an important role in practicing benevolence and forbidding evil in the society.

It is also concluded in this chapter that the Islamic central banks aim to achieve several economic objectives such as the achievement of balanced economic and social development in addition to the achievement of justice as to the distribution of income and wealth. The objective of achieving the highest employment level together with the stability of the value of money and prices is very important for the Islamic central banks.

When we explained the banking interest and usury in this part of the research, we explained the meaning and the kinds of usury in Islamic Shariah. It was noticed in this part of the chapter that the interest, whether banking or non-banking, is equal to the prohibited usury in Islam, and it has the same meaning.

Then, at the end of this chapter we dealt in detail with the Islamic credit facilities extended by Islamic banks. We came to know that the credit facilities extended by Islamic banks usually take place through the Islamic investment and finance methods that are included in the forms of speculations (Mudarabah), partnerships (Musharakah), trading (Mutajarah), and leasing (Ijarah) transactions. Also, most central banks in the Islamic countries obligate all Islamic banks operating under their supervision to extend their credit facilities through these Islamic methods as their banking legislations comprise a statement of the different industrial, agricultural, commercial, or other economic activities prevailing in the country, in addition to comprehending in these legislations a statement of the Islamic investment and finance methods that are suitable for extending the credit facilities through them to those sectors.

We have noticed within the clauses of this chapter examples of banking regulation by the central banks in Iran and

Pakistan, in addition to practical examples of the investment and finance methods employed in a number of Islamic banks when granting their credit facilities. It was established, in our analyses of these investment and finance methods that each economic activity has the finance methods appropriate to it, such as the industrial activity which has its determined finance methods to be used easily in it, and the same applies with regard to the rest of activities whether they are commercial, service, agricultural, or others.

CHAPTER 4

THE FUNCTIONS OF THE ISLAMIC CENTRAL BANK

INTRODUCTION:

The functions of the central banks are divided into two major parts. The first part concerns the control of banks and financial institutions, and the organization of their operations. The second part deals with the control of money supply in line with the objectives of the monetary policy of a country. Both parts of these functions are required in the contemporary Islamic economy as public interest and welfare dictate them.

The Islamic central bank sets and implements the monetary policy by using instruments and methods which would enable it to undertake and perform its vital role. For the Islamic central bank to perform its role in the economic life in the best manner, the local banks (whether Islamic or otherwise) as well as financial and investment institutions must follow its instructions, directives and guidance. If the banks and financial institutions fail to abide by the Islamic central bank's instructions, then it issues regulations which force them into compliance. The Islamic central bank's instructions and directives affect all members of society because they have regular dealings with banks and financial institutions which carry out these instructions.

The Islamic central bank can practice many conventional functions which do not conflict with the Islamic Shariah but benefits it in terms of modern technologies. If any conventional function contradicts the Islamic Shariah, we shall attempt to eliminate such contradictions by undertaking amendments. In case we are unable to effect these amendments, we shall then try to replace them with functions compatible with the Islamic Shariah.
Therefore, the researcher will deal in this chapter with the functions of the central bank, and show that these can be adapted to the Islamic central bank.

4.1 THE FUNCTION OF ISSUING MONEY:

The task of money issuance is one of the most important functions of the Islamic central bank. By means of it, the central bank can control money supply, and hence manage and organize it, then redistribute it through banks. This task requires care, attention, responsibility and the observance of the commands of the Almighty because it involves forbidden usury. The operation of money issuance undertaken by the conventional central bank differs from that of the Islamic central bank. The operations of banks - whether central or commercial - are always focused on the money trade. This difference stems basically from the fundamental difference between the Islamic economic system and the conventional one. The latter is characterised by the following two features which do not exist in the Islamic economic system:[1]

a) The prevailing conventional economic system mainly concentrates on the lending process, which is considered the main impetus of the economic activity. Therefore, a sizeable percentage of the amounts owned by investors emanate from borrowing from intermediate institutions such as the commercial banks.

b) The money issuance operation by the conventional central bank has a lending nature, whereas the central bank issues the money which is borrowed by the government. Contrary to that in the Islamic economic system, the money issuance process by the Islamic central bank does not rely on lending since there are special rules controlling this operation. It becomes a necessity for the central bank within the framework of an Islamic economic system to create adequate means to properly undertake the money issuance function. To explain the modus operandi of the Islamic central bank in issuing money and their management and organisation, we must review the concept of money and its Islamic origin, the functions it undertakes, in addition to the types of money under an Islamic economy.

4.1.1 THE ISLAMIC DEFINITION OF MONEY:

Some scholars used the term, prices, to denominate money, because there is a payment that takes place for commodities and services. Similarly, the term, Al-naqdayn[2] was used to denominate the dinar and dirham, or the gold and silver. According to Muslim canonists, money is divided into two parts:

a) Money by nature which stands for gold and silver.

b) Money by convention, which stands for metallic coins and the like in terms of banknotes. It was mentioned in the book of Al-Ahkam Al-Adleya[3] that money is the plural of cash, being

1 El Jarhi, Moobed, *Towards an Islamic Monetary and Financial System*, Cairo (Egypt): The International Union For Islamic Banks, 1982, p.9

2 Al-nagdayn is Arabic terminology for gold and silver.

3 For more details about Al-Ahkam Al-Adleyya book please see chapter 2, page 21 of this research.

gold and silver, whether coined or not, with gold and silver being called the two money units.[1]

The economists have defined money as: 'that object which is used by individuals and which is accepted in general and used as a means of exchange and a gauge of values and a deposit of wealth'.[2]

If we review the definitions given by Muslim canonists, we find that they were the pioneers in eventuating a definition for money which determines the characteristics of money. In this regard Ahmed Ibn Hanbal[3] said that money is everything agreed upon in general by people to be used as money. He stated: 'I hope that everything agreed upon in between them, such as the money adopted by general agreement of people, would not encompass harm'.[4]

Ibn Taymiyah[5] said: 'As for dirham and dinar, no natural or legitimate limit is known for them. This is due to custom and convention, because in the beginning the purpose was to set a standard for deals and transactions. Dirhams and Dananeers are nothing in themselves, but the means of transactions'.[6]

Ibn Quddamah[7] said: 'The prices are gold and silver.... Prices are the values of money and the capital of trades, and with which occur speculation and partnership'.[8]

---

1 Haydar, Ali, *Durr Al Hukkam Shareh Majalat Al Ahkam*, translated into Arabic by Fahmi El Husseini, Beirut (Lebanon): El Nahda Library, Vol. 1, 1969, P.103.

2 El-Kafrawi, Oaf Mohamed, *Money and Banks under the Islamic System*, Alexandria (Egypt): Egyptian Universities House, 1407H. [2nd edition], p.13.

3 Ahmed Ibn Hanbal is an Islamic scholar; he is the founder of Hanbali school.

4 Ibn Hanbal, Ahmed, *Al-Mosnad*, Beirut (Lebanon): Islamic Office, 1978, p.21.

5 Ibn Taymiyah, Ahmed, is a Muslim canonist of Hanbali School. He is the most famous follower of Hanbali School. He was born in Harrn, a town near Damascus and died in year 728H.

6 Ibn Taymiyah, Ahmed, *Al-Fatawa (Legal Counsels)*, Beirut (Lebanon): Arab Printing, Publishing and Distribution House, 1398H. Vol.19, p.251.
Al-Fatawa book is a fundamental Islamic book. It is considered as the most poplar reference in Hanbli School that consists a huge numbers of Islamic Decrees (Fatwa). This book has 37 volumes.

7 Ibn Qudamah, Abdullah, is a Muslim scholar of Hanbali School. He wrote numerous books about Islamic jurisprudence which became main references for Hanbali researchers and students. Hi died in year 620H.

8 Ibn Qudamah, Abdullah, *Al Moghni Ma'a Al Sharh Al Kabeer*, Beirut (Lebanon): Arab Book House, 1972, vol.2, p. 625, and vol.3 p.34.

Some Muslim scholars stated that money is what has been agreed to be considered as money, even if it is a piece of stone or wood.[1] Money has special characteristics. If made available in any material, this material would then be accepted as cash or as money, whatever it may be, and under any condition it would be. These characteristics are:[2]

a) That it would be a calculating unit.

b) That it would be a means of exchange and payment and would be generally accepted as such.

c) That it would be a measure of values.

d) That it would be a warehouse of wealth and a store for value.

Therefore, we see that Muslim scholars have gone ahead of other economists in determining a definition of money which pinpoints its characteristics. According to the foregoing, money is a moral thing, whether this significance stems from king's ruling or from people's acceptance. We can extract the following points out of our review of the economic and legitimate concept of money:

a) That money is what has been agreed upon to be considered as money, even if it is a piece of stone of wood. Money has not been determined by a certain form or by a specific metal, for what is taken into consideration with the canonists is the price ability.

b) There is agreement between the Muslim economists and experts as to the characteristics which must be made available in money, in terms of it being a means of exchange and payment, and as being a store of value and wealth.

c) That money is not required for itself, but is required in order to spend it on commodities and services.

4.1.2 THE MONEY ISSUANCE:

Money, in the Islamic age, was an extension of what it was during pre-Islamic times. The residents of Makkah in the pre-Islamic days used to deal in weights agreed upon between them, the measurements

---

1 Al Rasheed, Abdel Aziz, *Efadat al-Sa'el Fi Ahamm Al-Fatawa Wal Masa'el,* Baghdad (Iraq): Al-Rashid Publishing and Distribution House, vol.1, 1980 [2nd edition], p.113.

2 Shafei,Mohamed Zaki, *Introduction to Money and Banks*, Beirut (Lebanon): El-Nahda Printing and Publishing House, 1952, p.17.

being the Ratl (the pound) and the Oukiyyah[1] (ounce).[2] With the advent of Islam, Prophet Mohamed ratified this practice and agreed with the Makkah residents on the handling of money the way they used it, by saying, the scaling balance is that of Makkah. Then, the Prophet imposed the alms (zakat) on this money. He fixed its rate at five dirhams on each five ounces of pure silver, and imposed half a dinar on each 20 dinars.[3]

In the Prophet's time, there were several types of dirhams in vogue. But the most of the deals and transactions were conducted with the use of two kinds: Al-tabari and Al-baghli.[4]

The righteous Abou Bakr Al-Siddiq[5], during his caliphate, did not change or substitute the system of the noble Prophet as regards the subject or issuance of money and the alms (zakat). When Omar Ibn Al-Khattab[6], was elected Caliph, after the death of Abou Bakr, he ratified the money value used in the age of his predecessor, and so it was without any changes until the 18 Hegira year, after the increase of the Islamic conquests and the arrival of the caravans of Muslims to Persia and Iraq. So, he ratified the Persian money which was prevailing there. Yet, he added some Islamic phrases like, (Thanks to God) and (There is no God but Allah) and (God's Prophet).

Then Othman Ibn Affan[7], minted dirhams, engraved them and wrote on them (God is the greatest).[8]

---

1 Al Ratl (The Pound) equals twelve Ookiyya (ounce), and the Ookiyya (the ounce) equals to forty dirhams. Thus, the Ratl (Pound) would equal four hundred and eighty dirhams.

2 El Makrizi, Takeye El Dine, *Eghathat Al Oma Bekashf Al Ghumma (Assisting the Nation by Removing Grief and Distress)*, Cairo,(Egypt): Dar Ibn Al Waleed, 1957 [2nd. edition], p.47.

3 Ibid, p.51.

4 El Mennawi, Mohamed Abdel Raouf, *Money, Measurements and Weights*, edited by Dr. Rajaa Mahmoud Al-Samera'i, Baghdad (Iraq): Al Rasheed Publishing House, 1981, p.59.

5 Abou Bakr Al-Siddiq is the first Islamic Caliph after the Prophet Mohammed.

6 Omar Ibn Al-Khattab, is the second Islamic Caliph. He became Caliph after Abou Bakr Al-Siddiq.

7 Othman Ibn Affan is the third Islamic Caliph.

8 El Makrizi, Takeye El Dine, *Al Nuqud Al Islamyah(The Islamic Money)*, Al Najaf (Iraq): Al Haydariyah book shop publications, 1967 [5th.edition], pp. 7-10.

Abdullah Ibn El-Zobeir[1] was the first to mint the round or circular dirhams at Makkah. When Abdel Malek Ibn Marwan became caliph in 76 Hegira, he ordered that purely Islamic money would be minted in the form of Arabicised dananeer and dirhams. He eliminated and removed all the non-Islamic phrases while regulating the legitimate and lawful dirham which he ordered everybody to use.[2]

The Islamic money kept on being used by the Islamic nation, despite the change in its caliphates and leaderships. This money was always made of gold and silver, despite the difference in their standard caliber, in their forms, and their engravings. It was always based on weight. The dirhams had fixed weights. The dinars too had agreed upon weights determined by the Muslim rulers. The weights of this money, its calibers and its engravings differed from era to era. El-Makrizi expressed that when he talked about the fixed weight of the lawful dirham and dinar by saying: 'They are still the same - the dinars and the dirhams as Islamic money - since the era of the Prophet, with the possibility of their changing with the succession of rulers, and with what has been the custom to see the difference in the weight of the dinars, dirhams and weights when rulers are new'.[3]

The Islamic money in circulation (Dinars, Dirhams both golden and silver) in different parts of the Islamic world till paper money appeared at the end of the 18th century A.D. It's use expanded in several parts of the world, including the Islamic countries. Since that time, the use of the paper money became the principal means of transaction in Islamic countries, even though some of these countries still connected to Islamic golden and silver, with each one having its own currency at fixed and determined specifications and measures.

---

1 Abdullah Ibn El-Zobeir is a relative and follower of Prophet Mohammed.

2 El Mennawi, Mohamed Abdel Raouf, *Money, Measurements and Weights*, op. cit., pp. 59-87.

3 El-Makrizi, Takeye El Dine, *Eghathat Al Oma Bikashf Al Ghumma*, op. cit., p.52.

4.1.3 THE ORGANIZATION OF MONEY ISSUANCE BY THE ISLAMIC CENTRAL BANK:

Muslim canonists and jurists have confined the money issuance operation to the government alone, exclusive of individuals and private entities and institutions. For the country, represented by the ruler, is in-charge of the exclusive right of money issue. And the ruler is the one who would be capable of determining the quantity of money that is necessary to secure the progress of economic activity in the Islamic country, without any harm. When the ruler undertakes the task of money-issuance, he guarantees balance between money supply and demand to avoid inflation or deflation. The Muslims' ruler must take into consideration the market need. In other words, he would not increase the money supply against the necessary requirements of the market, so as not to affect the performance of the economic activity in the country. Similarly, he must not decrease money supply when the market needs it. In other words, he must achieve balance in relation to money supply without extravagance or avarice.

We know that Muslim rulers used to take this important point into consideration. Abdel Malek Ibn Marwan[1] laid a general mint for dirhams and dinars and sent it to El-Hajjaj[2], so that it would be sent to all Islamic countries. He then asked all Muslim rulers to calculate and enumerate whatever money is collected every month and to inform El-Hajjaj. All this was done with the aim of the enumeration of the currency and to keep a tab on its monthly circulation.[3]

Muslim scholars perceived and noticed, prior to others, the damages which could result from the imbalance of money supply on the market. So, they warned against the increase of money supply over and above the market need. El-Asadi said:[4] '... and if people would be compelled to deal in corrupt money, conditions would come to a halt, funds would be lost, gossips would increase, prices

---

1 Abdel Malek Ibn Marwan is an Islamic caliph during the age of Omawiayah Islamic state.

2 El-Hajjaj Ibn Yousif Al Thaqafi was a governor of Iraq during the prefecture of Omawiayah Islamic state.

3 El Makrizi, Takeye El Dine, *Al Nuqud Al Islamyah (The Islamic Money)*, op. cit., p. 10.

4 Al-Asadi, Khalil, *Ketab Al Tayseer Wal Eltebar Wal Tahreer Wal Ekhtebar Fima Yajeb Men Hosn El Tadbeer Wal Tasarrof Wal Ekhteyar*, edited by Abdel Kader Ahmed Tolayhat, Cairo (Egypt): Dar El Fiker El Arabi, 1968 [1st. edition], pp.115-134.

would change and litigation would take place against adversity and distress ...'. It is doubtless that forged or falsified money in society will lead to an increase in the offered or supplied quantity of money in society. And this is what Muslim scholars have warned against. For the quantity of money makes an important impact on Islamic economy. That is why it is a must to achieve and attain equilibrium in the supply, whether by increasing or decreasing money issuance.

For the money printing system in the Islamic central bank to be effective, the following points must be realized:[1]

a) To secure and guarantee the money subsidy and the achievement of its stability domestically and abroad.

b) To secure and guarantee the freedom of money exchange and the conversion thereof into other foreign currencies.

c) The availability of the religiously lawful cash covers for the issued currencies.

The guarantee of the money subsidy and the achievement of its stability both domestically and overseas cannot be done except by controlling the quantity of money issued according to the economic need.

In this global village, no country - however strong and mighty - can isolate itself from the rest of the world. The economic relationships among countries require currency conversion with ease and freedom. The Islamic central bank must play this role permanently to secure the free conversion of the local currency into foreign currencies as dictated by the nation's interest and welfare and as authorized and the Islamic Shariah.

Contemporary Muslim scholars have authorized foreign exchange operations under religiously lawful provisions of on-the-spot receipt and delivery. That is why it is very important for the Islamic central bank to lay down these rules which follow both the Islamic Shariah and the law and which govern the foreign exchange operations together with the follow up of their executive procedures and audit them accurately. It is even a duty for the control and regulation of the banking operations and for the upkeep of the stability of the local currency as well as for the preservation of the State's reserves of the foreign exchange.

---

1 El Jarhi, Moobed, *Towards an Islamic Monetary and Financial System*, op. cit., pp. 35-43.

As regards the availability of the religiously legitimate cash cover of the issued money, this does not conflict with the provisions of the Islamic Shariah. For the central bank's acquisition of gold, silver and other foreign currencies are a requisite and a source of power and support for the local currency. Therefore, the acquisition of these reserves has become a must and a duty of the central bank to increase the Islamic countries' potentials economically, noting that these reserves increase or decrease according to the level of economic activity in the country. This requires us to explain the rule of money issuance in Islamic economy, its cover and the preservation of its value would take place.[1]

(1) THE RULE OF MONEY ISSUING IN ISLAMIC ECONOMY:

There are two trends related to the money issuance operation:

a) Liberating the issuance of the money from any restriction, terms or condition. As a result, the central banks would be free to issue whatever money they would wish at any time they wish and whenever needed. The supporters of this trend justify this by noting that the central bank shall issue money in such a way as to suffice the needs and requirements of the market and in such a way as to cope up with the economic activities of the country[2]. This method has flexibility which makes it possible to provide payment methods at the time and according to the quantity required. However, this trend has also got its own negative aspects.

B) The second trend concerns restricting the freedom of central banks and obligating them to comply with restraints terms, conditions and laws which would limit their absolute and unquestionable freedom on money issuing.[3]

On the basis of these trends, economic experts have laid down several methods and ways for money issuance with fixed characteristics. These methods are as follows:[4]

---

1 Dunbar, Charles F., *Theory and History of Banking*, New York (USA): G. P. Putnam's Sons, 1901 [3rd. edition], p.79.

2 El Bei, Abdel Moneim, *The Economy of Money and Banks*, Cairo (Egypt): Al Shareq Al Arabi Press, 1956 [2nd edition], p.201.

3 Willis, H. P., *Theory and practice of central banking*, New York (USA): Harper Publishing, 1931, p. 264.

4 De Kock, M. H., *Central Banking*, London (England): Staples press, 1967, pp.26-41.

1- The partial fiduciary issue: Under this system, the central bank is authorized to issue money until these issues would reach a certain amount to be covered by governmental bonds only. If the bank finds itself compelled to increase these issues over and above this limit, it will have to cover any additional money issues exceeding this amount by gold in full.[1]

2- The maximum limit for the note issue: Under this system, the central bank determines a maximum quantity of money which it is entitled to issue without any gold cover stipulated upon. It is possible to change the maximum limit which was previously determined and have it fixed from time to time and without any gold cover under strength of a special law, according to the circumstances and requirements of national economy.[2]

3- The relative gold cover standard: This method stipulates upon the existence of two important issues, the first being to initiate a gold reserve at a certain percentage against the money issues, and in such a way that this percentage would be the minimum which must exist to cover any note-issues. The second of these two important issues is the coverage of the remaining balance of the note issues by certain other assets in the form of governmental bonds and commercial bills of exchange.[3]

4- The full gold cover standard: By means of this system, the central bank can issue as many notes as it wishes as long as it covers that in full and at 100% in gold.[4]

5- The free issue system: Under this system, the central bank is authorized to issue any quantity of money as it may estimate and according to the requirements of economic activity by means of resolutions from it without the availability of any

---

1 Koreissa, Sobhi Tadros, & El-Aqquad, Medhat Mohamed, *Money, Banks, Economic and International Relationships*, Beirut (Lebanon): El-Nahda El-Arabiyya House, 1983, p.147.

2 Lemoine, R. J., *Foreign banking systems*, edited by Willis and Beckhart, Paris (France): Henry Holt, 1929, p.533.

3 De Cock, M. H., *Central Banking*, op. cit., pp. 32-34.

4 El Beih, Abdel Moneim, *The Economy of Money and Banks*, op. cit., p.209.

gold balance or any balance of governmental bonds and commercial papers as a cover for this.[1]

As for the Islamic economic system, several Islamic economists tend to the necessity of the existence of fixed and specific restrictions imposed on the money issuing so that Islamic central banks would heed and observe the religiously legitimate rules when issuing money. There are general restraints for money issue in Islam which the Islamic central bank must observe and respect when undertaking this operation so that the Islamic bank would guarantee that the money issued responds to the market need and requirement and that it achieves parity and balance between the level of the economic activity prevailing in the country and the quantity of the methods of payment made available.

Muslim scholars believe that the acquisition by the Islamic central bank of gold, silver and foreign currencies do not conflict with the provisions of the Islamic Shariah. On the contrary, the reserves of gold, silver and foreign currencies with the Islamic central bank show the support factor to subsidize the strength and power of the local currency and for the stability of national economy. That is why some Muslim scholars believe that the acquisition by Islamic central banks of gold, silver and foreign currencies has become a must for the welfare the Islamic nation, for the support of its economy and its local currency.[2]

The Islamic central bank can ensure the cash cover or monetary cover required with the help of the government under which it operates, because it works as agent and advisor to the government. Consequently, the public budget of the government must be deposited with it, either for investment by it or for depositing only. Thus the sources of the public revenues of the government shall themselves be the principal sources of the funds of the central bank.

The acquisitioned monetary or cash cover with the central bank must emanate from sources which are allowed by religious rulings. In case the Islamic central bank would wish to invest the funds of the monetary or cash cover, then such an investment shall have to

---

1 Mare'i, Abdel Aziz, & Ibrahim, Issa Abdo, *Money and Banks*, Cairo (Egypt): Lajnet El-Bayan El-Arabi Press, 1962 [1st edition], p.397.

2 Rabwi, Mohamed Ibrahim, *The Paving of the Way for the Completion of the Application of the Provisions of Islamic Shariah in Economy*, a research Presented to the Seminar for Islamic banking held in Kuwait, during the period from 6-8 February 1992, p.7.

be done throughout those means which are authorised and blessed by religious rulings as well. The Islamic central bank's cash cover has an important role in giving that push, power and trust in the issued money. It also limits the authority of the central bank in case of excessive money issue operations, which would constitute a protective factor for national economy, shielding it against the crises. Under the Islamic economic system, the officials in charge of the central bank must work towards achieving the country's general economic interest and welfare, which is an obligatory duty entrusted them by God. The responsibility of achieving the public welfare under the Islamic system is not only against the president or the commander but is also a responsibility against God. If the officials in charge of the Islamic central banks feel deeply bout this important factor, then they will fear God and heed honesty and public interest when issuing money. This, in itself, is considered a restrictive factor which would limit the freedom of issue undertaken by the Islamic central banks.[1]

(2) THE PLACEMENT OF THE NEW ISSUE FOR CIRCULATION BY ISLAMIC CENTRAL BANK:

Since the central bank is responsible and in charge of money issuing and for organising money supply, it undertakes the printing of new banknotes and their placement for circulation. However, the money issue process by the central bank under the conventional system differs from its counterpart under the Islamic economic system. According to the conventional central bank system, the placement process of the new issue takes place against governmental bonds. Accordingly, the central bank undertakes the money issuing in two cases: first, when the government resorts directly to the central bank for borrowing from it to cover its budget deficit; second, when the central bank decides to undertake expansive operations on the market known as expansionary open market operations to restore stability to national economy by pumping new money into circulation. So, it would resort to lending banks and individuals to pump additional money into the economic activities by going down on the market as purchaser of the governmental bonds or through the rediscount operation of commercial paper.[2]

---

1 Ibid, pp. 8-9.

2 El-Jarhi, Mo'obad Ali, *towards an Islamic Monetary and Financial System*, op. cit., p.29.

It is to be noted that both the methods, whether lending the government or lending banks and individuals, are adopted to provide the country with the necessary resources. Yet they have several economic effects. Expanding on money by lending the government and the public has inflation effects which focuses and reflects on the interest rates in the long term. It also has bad effects on price index and on the distribution of wealth, which enables the owners of banks to become wealthier by creating new lending fields as a result of monetary expansion. Therefore, the central bank under the conventional system tries to determine the quantity of circulating money at the level which would achieve the greatest amount of reciprocal services, while at the same time up keeping the price stability.

The placement operation of the new issue into circulation by the Islamic central bank differs from the state of things in relation to the conventional system. The methods and rules adopted by the Islamic central bank do not rely on lending to the government or the individuals and banks only, but other bases which rely on following up the changing rate of prices and the growth rate in production to create an opportunity for pumping more money. Contrary to that, and in case of the occurrence of the increases of the prices which would dictate the central bank to reduce the growth rate of money in the market, then the central bank would withdraw part of the circulated money from the market.

The Islamic central bank relies in issuing new money on lending to government and Islamic banks or on the participation with Islamic banks. Through these two entities it undertakes issuing new notes, and have them placed for circulation.[1]

(2/1) LENDING THE GOVERNMENT AND ISLAMIC BANKS:

The central bank can place new issue of money into circulation if needed through the government by lending it the funds it needs as soft non-interest-bearing loans, and under special terms and conditions agreed upon by both entities. For example, if the trends of the economic policy of the country suggest investment in a specific field of activities which the private institutions would shy away from, then the central bank may exert its influence in lending to the government on condition that the investment would be directed towards this aspired field of activity. Thus the

---

[1] Abdul Kader, Mohamed Razif, *The Role of the Central Bank in the Policy, Regulatory and Supervisory Framework of Islamic Banking, in Malaysia*, a research presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait, March 1996, p.10.

central bank would be able to direct investment towards this sector or that. Similarly, the country may borrow from the central bank soft non-interest-bearing loans to cover budget deficit. The same applies to Islamic banks. The Islamic central bank can lend soft non-interest-bearing loans to the Islamic banks under special terms and conditions on the understanding that these loans would be invested in specific fields of activities to achieve public welfare. This does not conflict with the Islamic Shariah, because this falls in the category of loan and provision. This does not attract interest or benefit for the lender.

Therefore, the laying down of special terms and conditions by the Islamic central bank when lending the rest of the banks achieves public welfare and responds to the requirements of the economic and monetary policy of the country, provided this policy would not conflict with the provisions of the Islamic Shariah. Here, we must warn against exaggerating the use of the lending policy to banks or to the country. It is a must that lending would be at fixed times and under specific circumstances and under fixed terms and conditions so that these loans would not lead to opposite results.

(2/2) PARTICIPATION WITH ISLAMIC BANKS:

The participation of the central bank with Islamic banks enables it to pump funds required through these banks. The central bank opens accounts with the Islamic banks. In case the central bank wishes to pump new money into circulation, it would feed these accounts with new funds. The Islamic bank would invest these deposits in areas which would achieve its objectives and would agree with its trends and its expectations in line with the teachings of Islam. In case the central bank wishes to withdraw some money from circulation, it resorts to its investment accounts with the Islamic banks and withdraws the quantity which it believes would balance the monetary market. When the central bank invests its funds with the Islamic banks, it realises some profits as a result of that. Consequently, it can use these profits in covering some of its expenses or may lend for achieving the objectives of the monetary and economic policy of the country.[1] Moobad El Jarhi called these deposits made by the central bank with Islamic banks as the 'central deposits' and considered them a

1 Adek, Hussein Awang, *An Overview of Islamic Banking in Malaysia*, a research presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait, March 1996, Pages 7-8.

substitute which would replace some of the policies of the non-Islamic central bank based on interest[1].

4.2 THE ISLAMIC CENTRAL BANK AS THE GOVERNMENT'S BANKER, AGENT AND ADVISOR:

The Islamic central bank plays an important and effective role in the economic life of any State. For, on it, the governments rely in order to reach the economic objectives they seek out. The relationship between the Islamic central bank and the government is a reciprocal relationship, by means of which both parties realize interests and benefits. For the Islamic central bank enjoys the support of the government, which bestows it the legal and religious lawful characteristic thereupon. There is neither authority nor sovereignty for the Islamic central bank without the support of the government. Furthermore, the government grants the central bank the money issue authority, which reflects upon it several material and moral benefits as a result of this sensitive function. Against that, the Islamic central bank undertakes many services for the government, at the front of which stands the fact that it works towards the achievement of the economic objectives targeted at by the government. For the central bank is the means used by the government for the achievement of its economic objectives and goals[2].

Similarly, the Islamic central bank undertakes all the operations needed by the country or any one of its authorities. It receives and keeps the country's revenues. It also settles its payments and liabilities. It invests the country funds and manages them on its behalf. It holds its accounts and organizes them on its behalf. It also undertakes the management of the assets of the government in terms of foreign currencies, plus providing assistance and financing necessary for the government whenever needed.

The relationship between the Islamic central bank and the government is set up on reciprocity as a result of which each party realises benefits[3].

---

1 El Jarhi, Mo'obad, *Towards an Islamic Monetary and Financial System*, op. cit., p.68.

2 Basu, S.K., *A Review of Current Banking Theory and Practice*, Calcutta (India): Macmillan, 1978, PP.32-51.

3 Abdul Kader, Mohamed Razif, *The Role of the Central Bank in the Policy, Regulatory and Supervisory Framework of Islamic Banking, in Malaysia*, op. cit., pp13-14.

Therefore, we shall tackle in this part the relationship of the Islamic central bank with the government while dealing in this aspect with the most important functions and roles provided by the Islamic central bank to the government.

4.2.1 THE ISLAMIC CENTRAL BANK IS THE TREASURY OF THE GOVERNMENT:

The government, represented by its ministries, authorities and institutions keeps its accounts with the Islamic central bank. It consequently issues the government at the end of each specified period a statement of account showing its net balances. Accordingly, the Islamic central bank undertakes revenue collection of government authorities, whether from third parties or from any other entity. It deposits these revenues in the accounts of specific authorities.

The Islamic central bank also undertakes the payment of the expenses and disbursement from the account of the respective authorities or departments on their directive. These operations require that the central bank would open and hold regular accountancy ledgers and books for each entity/department, maintaining full operation and transaction details. These details are presented at the request of the respective department or authority at the end of a specified date.

The Islamic central bank also invests the surplus funds of various governmental departments or institutions. These cash surpluses are then invested through an agreement between the central bank and the entity concerned. Such an agreement determines the role of each entity, the fields of investment as well as the expected return. In addition to that, the government deposits with the Islamic central bank all the provisions and appropriations of the items of the country public budget. The central bank would keep these provisions or appropriations in special accounts. It then disburses them over the items of the country public budget according to the directives of the competent and related authority.[1]

---

1 El Kafrawi, Oaf Mahmoud, *Money and Banks under the Islamic System*, Alexandria (Egypt): Dar El Kutoub El Masryea, 1407 H, pp.37-41.

4.2.2 THE ISLAMIC CENTRAL BANK AS THE CUSTODIAN OF THE NATIONAL RESERVES OF INTERNATIONAL CURRENCEIS:

Each country holds with the central bank a certain balance in foreign currencies, and in some precious metals such as gold and silver. The country uses this balance to facilitate its trade exchange with the other countries, and to keep part thereof as a cover for its money issuance. Country's foreign exchange reserve is proof of the strength of its economy and the activity of its trade. The country resorts to the central bank, requesting it to keep its balance of foreign exchange. The role of the Islamic central bank here does not differ from the role of the conventional central banks, with the exception of the investment method. Under the Islamic economic system, the Islamic central bank keeps, manages and invests these balances in legitimate channels which agree with the Islamic Shariah, in case it deems necessary to invest them or part of them[1]. This takes place under strength of an agreement between the two parties concerned, the central bank and the government. It would be indicated in this agreement how these balances shall be invested, the investment duration, the roles and returns reflected back to each side as a result of such an investment. When the Islamic central bank decides to invest the foreign exchange balance of the government, it takes into consideration investment operation to find an adequate exit by means of which it could convert these investments into foreign exchange liquidity again if it would be in need of these currencies at any time and for any reason.[2]

Through the Islamic central bank's management of the foreign assets, a country tries to maintain the stability of the exchange rate of its currency in relation to the other currencies by using the balance of foreign assets.

4.2.3 THE ISLAMIC CENTRAL BANK AS GOVERNMENT'S FINANCIAL AND MONETARY ADVISOR:

With the human and material potentials available to the Islamic central bank and throughout the details and data it obtains, it is qualified to advise to the government authorities and departments

---

1 Ajameyya, Mohamed Abdel Aziz, & El Sheeha, Mostafa Roshdi, *Money, Banks and International Economic Relationships*, Beirut (Lebanon): The University Printing and Publishing House, 1982, p.181.

2 Uzair Mohamed, *Central Banking Operations in an Interest-Free Banking System*, a research presented at the Makkah Seminar on the Monetary and Fiscal Economics in Islam, Makkah: October 1978, p.19.

which need its services and consultations. This is considered one of the most important functions of the Islamic central bank, since it agrees with the provisions and teachings of the Shariah which induces the principles of providing advice and cooperation amongst all Muslims and providing advice and counsel to the ruler as well.

Therefore, the Islamic central bank, as a competent entity, and with the technical potentials and the human qualified forces, can provide its own recommendations and advice to government for guidance when laying down the country's economic and financial policies.

The Islamic central bank also has specialized bodies for the collection of information and their analysis. Therefore, it can provide the government with these details and information while formulating financial and economic policies. The country can achieve its economic objectives with the assistance and help of the central bank. It is the key instrument which lays down and implements the monetary and economic policies of the government by using its methods in line with the Islamic Shariah.

The Islamic central bank also provides its financial and economic services and consultations to the government agencies at the time of the signing of agreements with other countries. It has the necessary and important information about the economic activities in countries, and foresees the advantages and risks of signing such agreements. On basis of information it gets about other countries, it submits its recommendations to the government. The Islamic central bank has to undertake the function of the financial agent of the government with the international and regional institutions and Funds, as a result of which it must undertake all the government's transactions and deals with those agencies.[1]

4.2.4 THE ISLAMIC CENTRAL BANK AS THE ORGANIZER OF THE COUNTRY'S PUBLIC DEBT:

Amongst the responsibilities of the central bank, as the financial agent of the country and its advisor, is organizing the public debt. According to the general banking system, the public debt is one of the financial resources of the country, and an important instrument for the funding and financing of public expenditure. It is a loan to which the members of the public or banks subscribe to

---

[1] Uzair Mohamed, *Central Banking Operations in an Interest-Free Banking System,* op. cit., pp.7-9.

the bonds related thereto or to whose bonds foreign governments and international financial organizations would subscribe.[1]

The public debt is the government's borrowing of certain loans from various and different entities against a determined interest. These loans are not permissible under Islamic law, for they are considered a loan with a precondition of an increase against deferment. This is, in itself, is considered as one of the form of the debt usury. As for the Islamic economic system, the public loan operation must assume its rules and principles out of the provisions of the Islamic Shariah. The country may not borrow at interest, but must borrow its needs on the basis of the non-interest-bearing loans and on the basis of the provisions of the tolerant Islamic Shariah. Under the conventional economic system, the government's domestic borrowing operation assumes many forms. It may be in the form of market loans or treasury notes or treasury deposits receipts or other forms of domestic borrowing. Concerning the market loans, the government acquires them to meet some of its expenditures. The method applied to this effect lies in the government issuing long-term and medium-term bonds bearing various interest rates. Investors, whether individuals or institutions, purchase the marketable bonds for returns. As for the treasury notes or bills, they are in two kinds, the first kind is that of treasury notes of a determined purpose which the government issues to the central bank for a determined purpose and goal at a low interest rate to face certain financial needs. Their period is for about three months. They are mostly renewable. The second kind consists of treasury notes for an undetermined purpose, also interest-bearing, with mostly a period of three months. The commercial banks usually purchase them to make some profit because they are easily discounted with the central bank. In connection with the treasury deposit receipts, they stand as being financial instruments through which the government enables individuals to invest their surplus funds through purchasing governmental treasury deposits receipts. The maturity ranges for these receipts are between three months and one year. It is against a fixed interest which varies according to the maturity date or duration of each treasury receipt. These receipts are discountable with the central bank. As for the Islamic economic system, all the previous instruments in question must be changed

---

1 Fawzi, Abdel Moneim, *General Finance and Financial Policies*, Beirut (Lebanon): Dar El-Nahdah El-Arabeyya, 1990, p.37.

or amended because the basis of their process relies on the interest rate.

In relation to the market loans by way of the government's issue of long-term and medium-term bonds, this practice must be stopped as they rely on a fixed interest rate when applying the Islamic economic system. Instead, there must be an issue of non-interest-bearing bonds or profit and loss participation or sharing system.[1] The treasury notes with a determined purpose or those which are issued for an undetermined purpose must be stopped when applying the Islamic economic system or to have them issued without interest through the use of the Islamic investment methods to allow some profits for the investors. The same thing applies to the treasury deposits receipts, the issue of which must be stopped when applying the Islamic economic system and have instead of them determined issues which would enable individuals and investors, provided these issues agree with the teachings of Islamic Shariah.[2]

Methods and instruments of Islamic investment which could be approved as bases for lending governments have expanded to several countries. We have read in the news that major international banks have opened its branches for Islamic operations and transactions.[3] Thus it would be possible to benefit from the potentials of these banks in organizing the lending to some governments in line with the Islamic Shariah. However, it must be mentioned here that the Islamic Shariah has laid down restrictions for lending to Islamic governments, whereas it has allowed the Islamic governments to resort to borrowing within very narrow limits and only under circumstances when there is a real need for borrowing. According to the provisions of the Islamic Shariah, the country must rely on its revenues out of the economic and public projects first of all and then resort to the sovereign resources such as duties, tributes and taxes. If the revenues resulting from these two

---

1 Dato Ahmed Taiudin Abdul Rahman, *The Operational and Technical Aspects of the Islamic Bank - case, Study of Bank Islam Malaysia Berhad*, a research presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996, pp.8-10.

2 Hidzir, Yahya, *The Monetary Policy Consideration in the Implementation of Islamic Banking in Conventional Environment*, a research presented at the Symposium on the Malaysian Experience in Islamic Banking, Kuwait: March 1996, pp.12-14.

3 For more details about Islamic modes for investment and finance, please refer to page no. 77 of this research work.

sources are not sufficient for spending on the public utilities then the country shall have the right to resort to borrowing.[1]

Furthermore, the Islamic country must prior to indulging in borrowing undertake accurate planning operations of its resources and expenditures so that it would be able to sound its potentials for repaying the borrowed funds. It must also prepare itself for pitfalls during financial crises, which may weaken its ability to honor its own obligations. We shall quote some jurists who have tackled this issue. Imam Al-Ghazali[2] says[3]: 'We cannot deny the permissibility of borrowing and the necessity of obtaining it thereto if the benefits of the nation would dictate such action. However, if the ruler has no hope to generate funds to the public treasury, then it won't be advisable to resort to the borrowing while having empty hands at present, and the loss of hope as to funds in future'.

This refers to the permissibility of borrowing from third parties if public interest would dictate that, provided there would be an anticipated planning conducted by the ruler as to the way he shall be able to secure the necessary funds for the repayment of the loan, especially if and when he would be informed about the scarcity of the sources flowing into the public treasury, and the non-availability of the sufficient liquidity with the country.
Imam El-Shatby[4] also said: 'Borrowing under crises can only take place and be done whenever there is hope of an income into the public treasury. However, if nothing is expected with a weak existence of income so that it would not satiate much then it is a must to effect placement'.[5] That means it is permissible to borrow under crises. But if the sources of funds would weaken and dwindle and which pour into the public treasury, the ruler shall have to impose some funds on the well-offs as an irretrievable tax. This

---

1 Donya, Shawki Ahmed, *Development Financing Under an Islamic Economy*, Beirut (Lebanon): Al Resalah Establishment, 1404 H. p.502-505.

2 El-Ghazali, Abo Hamid Mohammed is an Islamic scholar who was specialist in the fundamental of jurisprudent and its philosophy. He wrote numerous books in these fields. He died in year 505 H.

3 El Ghazali, Abou Hamed, *Shefa'a Al Ghaleel Fi Bayan Al Shabah Wal Mukhayyal Wa Malek El-Ta'aleel*, edited by Dr. Hamad El Kobees, Baghdad (Iraq): El-Rashad Press, 1971, p.241.

4 El-Shatby, Imam Abou Ishak Ibrahim Ibn Moussa El Lakhmi, is Islamic jurisprudent scholar. He died in year 790 H.

5 El Shatbi Abou Ishak Ibrahim Ibn Moussa, *Al-E'etessam*, Beirut (Lebanon): Dar El Ma'arefah, 1983 , p.123.

means that it is a must to effect placement. If the Islamic country would need, due to pressing circumstances, loans, and was aware that its revenues are not sufficient to respond to the needs, then it could resort to borrowing from third parties. The Islamic central bank would stand here as being the means and method through which the country would borrow from third parties. It shall be the one that will look for lenders and it would be the one to negotiate with them on behalf of the country to realise the best benefits and advantages. It would then plan for the country the repayment installments by means of which the loan would be paid back to the lenders. All that in accordance with the provisions of the Islamic Shariah.

The country may borrow by means of profit sharing contracts or by means of speculation contracts or by participation contracts or by means of any suitable form of Islamic funding and investment. The central bank would then control the country's repayment movement of these loans until the lenders would get back all their funds which it had borrowed from them.

4.2.5 THE ISLAMIC CENTRAL BANK AS THE LENDER TO THE GOVERNMENT:

In addition to the Islamic central bank's organisation of the public debt, it plays a very important role in funding and financing the government. The funding of the government takes place either by lending or by participating with it in some developmental projects.

1. FINANCING THE GOVERNMENT BY LOANS:

In order to finance its own additional expenditures or to finance and fund the deficit on its public budget, governments may resort to borrowing from individuals or from the banking system. However, the lending operation to the government by individuals, private institutions and banks remains mostly limited. These individuals and institutions aim at realising profit primarily by way of returns and interest from their lending to the government. But under the Islamic economic system, it is not permissible to deal in interest, borrowing or lending. That is why lending to the government with interest is not permissible according to religious law. Therefore, the lending motives are either to realise returns materially under agreements concluded with the government against the loans or to achieve moral benefits as a result of their having extended support to the government. The motive may also be the religious or national duty or out of obligation and compulsion. Whatever the form of the loans, we find them mostly limited and only contribute a limited relief. That is why governments resort to the Islamic central banks for borrowing. Lending by the Islamic central bank to the government assumes many forms. The loans might be short-term to fill in temporary gaps between the receipts or encashment of the government and its payments. These loans would then be soft loans without interests. That is because the profits realized by the Islamic central bank would go back to the government.

The loans might also be short-term ones on treasury notes without usurious interest, which the Islamic central bank would buy from the government. But then the loans could be either long-term or medium-term, whereas governments may be compelled to spend on some infrastructure projects. It is then that the Islamic central bank would provide its medium or long-term loans to the government. These loans must be devoid of usurious interests. The government and the Islamic central bank may agree to a method sanctioned by religion by means of which a certain return would be realised for the bank against the loans. In this case, the loans would be provided according to the forms of Islamic funding or financing which are allowed by the Shariah. The Islamic central bank may also purchase long-term governmental bonds, divorced from usurious interests for providing these loans.[1]

2. FINANCING THE GOVERNMENT BY PARTICIPATION:

Besides the financial loans discussed above, governments resort also to another kind of financing by the Islamic central bank. This is financing by participation. Here the Islamic central bank joins with the government as a partner in projects such as the telecom and electricity projects and in setting up macro-factories. These projects are needed for the development of the country. At the same time, it is possible that they could be profitability centres reflecting. Therefore, when the Islamic central bank finances such projects, it enters as a partner to the government at a rate equivalent to the funds it had provided. Thus it would achieve benefit and interest from the profits yielded by these projects, in addition to its having rendered a service to

---

[1] Siddiqi, M.N., *Islamic Approach to Money, Banking and Monetary Policy, A Review*, a research presented at the Makkah Seminar on the Monetary and Fiscal Economics in Islam, Makkah (Saudi Arabia): October 1978, PP.11-14.

the country by solving its financing problem. The central bank can also use its shares in such companies and projects to achieve the aspired equilibrium on the money market. In case it notices the rise in the volume of payment methods which may threaten inflation, it enters the market as a seller of a certain percentage of those shares it has to absorb the value. On the other hand, when there is a decrease of the payment methods in society, it resorts to enlarging its participation in such companies and projects to pump more money into the market. By means of this method, the central bank can achieve balance as aspired on the monetary market by stepping either as purchaser or seller of its own shares. As for the profits which are generated from entering into such projects, the Islamic central bank can use them for financing its operations if needed. Undoubtedly, the entry of the Islamic central bank as a financier of the government and as its partner in some projects has important developmental effects on the economic and social aspects of the country.[1]

4.3 THE ISLAMIC CENTRAL BANK IS THE BANK OF BANKS:

The economic systems all over the world, even though each country has different programmes, emanate from the banking laws which formulate a framework for the supervision and control over the commercial banks operations. The main reason behind this is the direct effect of the banking activities on the national economy. Moreover, the banks basically deal in third parties' funds. Their self-resources represent only a very small percentage of the total funds they hold.

Therefore, control operations over banking activities have become a pressing need. Banking activities are inconceivable whether in relation to the private, public or even joint banks and whether these banks are commercial, specialized, Islamic or even branches of foreign banks. There are several aspects of banking control. We have internal control represented by the control, auditing and inspection agencies inside the banks themselves. There is also external control. External control may be by some of the country's agencies. It could also be from part of the external auditors. However, there remains the important aspect and most effective and efficient one in supervising and controlling the operations of banks and banking activities which lies in the

---

1 El Jarhi, Moobed, *Towards an Islamic Monetary and Financial System*, op. cit., pp.63-66.

supervision of central banks over all units of the banking system. The activity of the central banks to this effect includes the inspection operations which they conduct over the banking units operating inside the boundaries of their countries, including the inspection of the ledgers and books with the aim of ascertaining the validity and soundness of their assets and of the operations they undertake. That also includes formulating rules for banking work, together with the determination of the fundamental statutes governing the banking activity within and inside the country. The matter even exceeds that when central banks sometimes interfere in the selection of the boards of directors of banks, together with those officials in charge of their executive entities either directly or throughout the imposition of certain specifications or qualifications which must be made available in the members operating as member of the board of directors in those banks or in those who occupy senior management positions.

The relationship of the commercial banks with the central banks is not confined to the control and supervisory facets only. It is also based on cooperation, assistance and support. Commercial banks very frequently resort to the central banks asking for support during crises or financial straits. That is why central banks have been called the last resort relief.[1]

Moreover, the central banks undertake coordination and organization operations in between the commercial banks. It undertakes for them clearing and set-off operations, which saves effort. In case the commercial banks need borrowing, they resort to the lender in the banking system, namely the central bank.[2] Islamic banks do not represent something different to this effect, and in this field. They are also subjected to the control of central banks, comply with the rules and resolutions, receive their support and assistance, and are favored with their shares of their loans. Islamic banks represent one of the constituents of the banking system. However, what is noticed at present and in many countries, is that the nature of the relationship between the central banks and Islamic banks has not had its features clearly defined. This may be due to the fact that Islamic banks are relatively new in origin. Central banks in many countries are still in need of global understanding of the operations and

---

1 De Kock, M. H., *Central Banking*, op. cit., pp.94-101.

2 Ibid, pp. 112-115.

activities of Islamic banks and most of the laws and regulations of central banks being derived from sources which do not agree with Islamic Shariah.

It is noticed that Islamic banks do not achieve the required benefit from the central bank in its capacity of last resort lender. Conventional banks can resort to central banks when they need liquidity. We find that the matter is to a certain extent complicated in relation to Islamic banks. They cannot resort to central banks under the present position of central banks, because of the conflict with the foundations on which the Methodism of Islamic banks is based. That is why it is a must for Islamic banks to remedy this problem to retain a high rate of liquidity with what that might cause in terms of the loss of investment opportunities and the inability of these banks to play their role in economic development.[1]

Similarly, most of the laws and regulations of the central banks encompass fixed Articles which prohibit the banks from undertaking trading and investment in certain activities such as wholesale or retail trade, and import and export activities, or in the appropriation of equipment and machinery or leasing them to third parties. All these prohibited operations constitute the core of the operations of the Islamic bank which it must undertake.

Therefore, preventing the Islamic banks from playing the role it is required to play, greatly harms it. The existence of such laws of central banks, while keeping quiet about the activities undertaken by Islamic banks lead them into practicing operations which are in contravention to the regulations and laws, and will expose them to sanctions and investigation.[2] For this reason we deem it necessary that the officials in charge of laying down the economic and monetary policies of any Islamic country would take these issues into consideration and should heed the distinct nature of Islamic banks by formulating laws and regulations which suit their nature and activities. This must be done in such a way that there would be no conflict with the important objectives of the economic and financial trends of the officials in charge.

---

1 El Hindi, Adnan, *Central Banks and Islamic Banks*, a research presented to the Islamic Banks seminar, Between Fact and Practical Application, Amman (Jordan): December 1988, p.6.

2 Ahmed, Ahmed Mohye El Dine, *the Role of the Central Bank in Relation to the Islamic Banks*, a research presented to the Islamic Development Bank seminar about the relation of the central bank with the Islamic banks, Jeddah (Saudi Arabia): 1991. pp. 7-10.

Although Islamic banks are operating in several Islamic and non-Islamic countries, but the nature of their relationship with central banks is still in need of reconsideration and reorganization. This must be done to enable them perform their role efficiently to serve the general principles of the country's economic policy. That is why the researcher believes in the importance of tackling this issue in this part of the thesis to clarify this relationship and to create rules which could be used as guidance in practical life. Therefore, this part of the research work will be confined to the funding and lending aspect, in addition to the supervisory and organizational one. As for the subject of control over banks in order to upkeep credit within safe limits, this issue will be tackled in chapter five of this research work.

4.3.1 THE ORGANIZATIONAL RELATIONSHIP BETWEEN CENTRAL BANKS AND THE ISLAMIC BANKS:

The organizational relationship between the central bank and the Islamic bank starts from the inception, continues through the operating stage, and ends with the liquidation or closure of the bank.

The determination of the organisational role of the central bank vis-a-vis the Islamic banks since the beginning shall have the best effect in the organization of the Islamic bank by performing its works optimally, while being the interceptor against any problems or argumentation or hesitation which could occur in the future when the Islamic bank shall start its effective activity. The organisational relation between the central banks and the Islamic banks encompasses several fields, of which: the foundation requirements, the activity and operating fields, management controls, and the controls of the variations which may occur to the financial positions such as the increase or decrease of the capital, as well as the expansion in branches, and the merger or liquidation operations, or the optional and voluntary stoppage.[1]

[1] Mohamed, Abdul Halim, *supervision and Examination of Islamic Banking Operations*, a research presented at the symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996, pp.7-26. and Yusof, Fadzil, *The Legal Aspects of Islamic Banking in Malaysia*, a research presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996, pp. 7-21.

(1) DETERMINING THE FOUNDATION SAFEGUARDS IN THE ISLAMIC BANKING SYSTEM:

It is necessary to identify the foundation terms and conditions of the conventional banking system to make sure they suit the Islamic banking system. Through them, we can adapt the Islamic safeguards which suit the Islamic economic system. We can even use same of the conventional banking system terms and conditions if they satisfy the same need and follow the Islamic Shariah. The central banks, under the conventional economic system, determine special curbs or safeguards to accept the registration of a certain institution as a bank and to authorise it to practice this profession. Frequently, those safeguards deal with the legal status, the minimum capital, the number of founders and their nationalities, the method of collecting the foundation funds or participations, the method of running the work by the board of founders, control over the bank's accounts, and other restraints.

The terms and conditions differ from one banking system to another, according to the characteristics and features of each system and according to the monetary, credit and banking policy it adopts. Some systems may facilitate the foundation requirements with the aim of accepting and setting up a large number of banks. They might be tightened by other banking systems, with some systems even going to the extent of stopping the foundation of new banks, regardless of whether they have fulfilled the foundation terms and conditions or not. For example, the Banks and Credit Law in Egypt have fixed the foundation provisos as follows:[1]

a) That the institution requesting the foundation would be an Egyptian Joint Stock Company (or a Joint Stock Company under formation) and would have nominal shares.

b) That the fully paid capital of the institution would not be less than 500 thousand Pounds.

c) That the members of the board of directors and the officials in charge of management would all be Egyptians[2].

d) The precondition of the approval of the board of directors of the Central Bank of Egypt as to registration.

---

1 Egyptian Central Bank, Banks and Credit Law No. 163 of 1957, Articles from 20 to 23, and Article 3 of the Executive Statute of the Law.

2 This proviso was cancelled, when foreigners were authorised to establish banks, within the framework of law No. 43 of 1974, and its amendments.

As for the banks control system in the Kingdom of Saudi Arabia, it has stipulated the following items related to the foundation safeguards for any institution which would wish to become a bank practicing a banking work:[1]

a) That it would be a Saudi Joint Stock Company.
b) That its fully paid capital would not be less than two million and a half Saudi Riyals, and that all subscriptions to the capital would be fully paid in cash. That the founders and members of its board of directors would be well-reputed.
c) That the Minister of Finance and National Economy would agree to its foundation contract and statute.

In the Kingdom, it is preconditioned to establish a foreign bank's branch or branches to fulfill the terms and conditions which are determined by the Cabinet, according to the proposal of the Minister of Finance and National Economy, with the permit being issued under all conditions and circumstances by the Minister of Finance and National Economy after the approval of the Cabinet. The same law has prohibited it for any person unauthorised to practice banking operations in Saudi Arabia, to use the word bank and its synonyms or any other expression similar to it in any language whether in its documents, or printed-matter, or commercial address or publicity.

As another example of the foundation checks imposed by the central banks, we find that the English Law has fixed the requisites which must be fulfilled by any institution to be acknowledged as a regular, authorized bank, and which stand as follows:[2]

a) That the institution (or the shareholders in the new institution under foundation) would be of good repute and excellent position in the financial community.
b) That the institution would provide(or would undertake to provide) either a varied number of integrated banking services, or that it would specialize in performing one banking service at a very high and advanced level.
c) That the institution would encompass amongst its founders or amongst its management, a number of persons of banking

---

1 The Banks control system promulgated by royal edict under number M/5 dated 22/2/1386 H., in addition to the Ministerial Cabinet decree number 179 of 5/2/1386 H.

2 Cooper, John, *The Management and Regulations of Banks*, London (UK): McMillan Publishers, 1984, pp. 251-253

professional efficiency, in such a way as would agree with the size and level of activities undertaken by the institution.

d) That the institution would be actually run by at least two of the banking efficiency qualified persons.

E) That the net assets of the institution would not be less than one million Sterling Pound for the institutions which perform integrated services. As for the institutions which specialize in one banking service, the net assets thereof must not be less than one quarter million Sterling Pound.

G) That the institution would upkeep and retain the net assets, in addition to its other resources, to constitute enough funds to begin and operate the institution according to the nature of its activity.

The same thing applies to the United States of America, which laid down laws which determine the foundation checks of banks, since the process of granting any institution a licence to practice banking operations takes place either via the entities which are attached to the Federal Government, which this kind being called national banks, or via the States' governments, in which case they are called State banks. The bases on which the licence is being granted have been determined on two basic criteria being:

a) The worthiness criterion: Which guarantees the soundness of the foundation systems of the bank, as well as all that is related is the provisos of the founders and administrative staff's professional and banking experience and their good reputation in addition to the provisos of the bank's financial structure.

b) The society's need criterion: Which stipulates upon the necessity of the existence of a pressing need of the services which this bank will provide to society.[1]

According to the foregoing mentioned in these examples of banking systems, we see that the foundation checks under these conventional systems focus on two basic points:

1- The provisos related to the availability of certain characteristics in the institution requesting and applying for the licence, such as the number of founders, the capital, the legal status, the fulfillment of professional and banking experience as

---

1 Dudley G. Lucket, *Money and Banking*, New York (USA): McGraw Hill Book Company, 1980 [2nd. edition], p.63.

well as good reputation and the procedures followed in the presentation of the foundation applications.

2- The provisos of the activities of this institution not conflicting with public interest and the interest of society, as it is a must that there would be special need for it in society.

According to the foregoing, we can confirm that the conventional foundation checks used in the conventional banking system, which we have previously tackled in this part of the research work can operate in an Islamic banking system. Therefore, the central bank

Consequently, there are some major points that the central bank must heed, and must make sure that they are fulfilled in any institution requests to become an Islamic bank. These points are:[1]

1- To check the statutes of the Islamic bank to make sure that they comply with the provisions, terms and conditions of the central bank as well as the Islamic legislation. It would be also better if the central bank would lay down a unified pattern, as much as possible, of a statute or of the articles of association of an Islamic bank which would take into consideration its distinctive characteristics, nature and fields of activities.

2- To ascertain the operational efficiency of the bank, starting with the feasibility study, the funding instruments and the investment instruments suggested, together with the profit or participations margins.

3- To ascertain the sufficiency of the capital in light of the investment natural risks related to the work of the bank, in such a way that it would not be less than a certain minimum limit.

4- To ascertain the existence of a large base of shareholders in the bank to buckle off hazards and risks.

5- To check up the contracts and specimens which will be used by the bank applying for the licence, and in such a way as would upkeep the interests of all parties concerned, in order to avoid individual or erroneous interpretations.

6- To ascertain the existence of an accountancy system, and an internal financial control system, prior to inception of work and operational activity.

7- To ascertain the existence of the accounts auditing entities, due to the special and distinctive nature of the Islamic bank.

---

1 El Tamimi, Yunes, *the relationship of the central banks with Islamic banks,* a research presented to the Seminar of the Islamic Development Bank, Jeddah (Saudi Arabia): 1991, p.10.

8- To ascertain the efficiency of the chief executive official on both professionally and Islamic jurisprudence levels, as well as the efficiency of the remaining executive and administrative officials, and to express opinion as to the chairman and members of the board of directors.

9- To ascertain the existence of an legislative board in harmony with the Shariah or the existence of at least one reliable and trusted religious advisor. The central bank may consult with competent entities as to the extent of his efficiency, strictness and knowledge.

10- To ascertain the existence of a certain modus operandi for the security up keeping of the interests of depositors, and the holders of investment accounts and not only for shareholders, throughout representation on the board of directors or on the general assembly (one way or another).

(2) DETERMINING THE MANAGEMENT AND OPERATING CONTROLS UNDER THE ISLAMIC BANKING SYSTEM:

By the management and operating control, we mean all the checks related to the bank's practice of its usual functions, and its various activities, which guarantee the bank's practice of its functions in accordance with the method determined by banking Islamic legislations, with the aim of protecting the interests of depositors, and the preservation of their funds, and in order to upkeep the financial position of the bank within safe and profitable boundaries. Through the management and operational checks, the central bank can create a follow-up, data and inspection system as regards all the banks, to enable it to create for itself sound channels which would guarantee the flow of information into it from all banks in due times, so as to enable it to make the adequate decisions which would suit each and every situation. The management and operating checks differ from one banking system to another. Some of them are strict, and some are more lenient.

In order to identify the management and operational checks in the Islamic banking system, we must study those restraints or checks under the conventional banking systems, then take out what would suit us, while modifying what could be amended, whereas the management and operational checks under most of the conventional banking systems in all different trends revolve around several points which we indicate hereunder:[1]

1- Compliance with the legal status and form required for the bank, which, in most cases, assumes the form of joint stock companies, with the consequential eventuating of the suitable managerial and organizational specimen involved.

2- Organising the work of the bank's managers in other banks or other institutions which are connected with banks and banking operations.

3- Organising the relationships inside the bank, in terms of the relationship of the senior management with staff members and the relationship of the senior management with the bank, and the relationship of the staff members, one with the other.

4- Formulating curbs over some fields of investment, such as investment in real estate and movables in relation to commercial banks, or the acquisition of the shares of the bank itself, and the prohibition of placement in precious metals and currencies, and the prohibition of placement in those activities legally banned.

5- Prohibition of the issuance of notes payable to bearer at call.

6- Organising the pricing operation of banking services including depositing and lending services.

7- Fixing data and other details which must be published annually to the public, or at different intervals.

8- Precondition of insurance coverage of the deposits under some banking systems.

9- Precondition of following and applying a unified and stable policy for the assessment of the banks' assets.

10- Laying down of special restraints and control checks related to the acceptance of deposits with non-commercial banks.

11- Laying down of restraints and control checks related to the foundation of affiliated establishments, or related to the purchase of their shares, or for the acquisition of outstanding companies.

12-Determination of the maximum limit of what any bank would issue in terms of bonds, together with the terms and conditions related to their issuance.

---

[1] El Rabi'ah, Seoud Mohamed, *The Conversion of a Usurious Bank into an Islamic Bank*, vol.2, op. cit., pp.325-343.

13- Preconditioning the existence of an external or outside auditor, to audit the bank's accounts.

All these restraints or check points may not exist under a certain conventional banking system, for some may exist, while the others are neglected or ignored under a certain banking system.
As for the Islamic banking system, most management and operating restraints under the conventional banking systems, and which we previously mentioned, do not conflict with the provisions of Islamic legislation, nor with the characteristics of the Islamic bank and the principles on which it is based. However, there are some items, which we would like to comment on, which must be taken into consideration so that they would be in full compliance with the provisions of Islamic legislation, and which would also agree with the distinctive characteristics and features of Islamic banks. These points are:

a- The constitution of the Islamic bank as a joint stock company: The specimen of constituting the Islamic bank as a joint stock company is acceptable under Islamic Shariah. But we must take into consideration that the shareholders, whose hold in the total resources of the bank does not exceed 10%, and speculators get the right to manage and run the operations of the bank and select its management and dominate its affairs. But the depositors who provide most of the funds and which might reach up to 90% of the total resources are deprived of any management right. They just have to wait for the realisation of profits or losses, as being representatives of holder of funds, which, in itself, is a loophole to be held against the specimen of the joint stock companies.[1]

b- Similarly, the auditors who control the operations of banks, and audit the authenticity and soundness of the acts of management, are selected by the shareholders' general assembly, that is to say by the speculator. Therefore, the auditing accuracy will depend on the auditors' professional conscience more than anything else. This being also another loophole which should be added to those of the specimen of the joint stock companies. Until there would be an adequate specimen and legislative system that would suit and fit in with the Islamic banks, agreeing with their distinctive nature, there is nothing against using the specimen of the joint stock companies, with its loopholes.

---

1 Ibid, p.357.

c- The activities where dealing or investment is prohibited: There are two kinds of prohibited activities determined by the banking systems which prohibit dealing in: one prohibited by the law in each country because it violates the international systems and practices, as a result of which most countries banned dealing in it, such as drug trafficking, money laundering and trading in human organs. The other kind is banned and prohibited because it affects the banking activity and its nature in a direct manner.[1], the Islamic banks, with their distinctive advantages, comply, more than the other banks with banning transacting in such activities, as they are considered sinful, and as these banks operate in what would get them closer to submission and obedience to God through the ruler. In connection with the activities related to the banking activity, and which are prohibited and banned by banking legislations, as they directly affect several aspects of economic life, we shall find that the Islamic banks comply with refraining from dealing in some of these activities, whereas it is difficult for them to abide by some others due to their special nature. What can be complied with is like the prohibition of speculating on precious metals and currencies. For, though this transaction seems, in form, acceptable Islamically, yet, it is, in reality, built on some sort of gambling connected with conceit and ignorance, and conflict with the nation's priorities, also contradicting the characteristics of the Islamic bank as a real investment entity. As long as these operations are connected with gambling, they are banned by Islamic legislation, while being allowed to deal in if they are set up on ordinary trading by selling and buying without any deceit or ignorance.

Concerning the activities which are difficult for the Islamic bank to comply with, such as the prohibition of investing in real estates and movables, they are activities which are difficult to comply with, for the core of the work of Islamic banks concentrates on investment in real assets, such as fixed assets, or current assets, machinery, equipment and goods and others. For all the forms of Islamic funding, financing and investment agree to the precondition of that existing. It is inconceivable that the Islamic bank would practice its work and activities away from dealing in real estates and movables, as that was confirmed by practical application to Islamic banks. That is why insisting on

---

1 Kabbara, Abdulrahman Haitham, *Islamic Banks*, Beirut (Lebanon): Publications of Union of Arab Banks, 1989, p.37.

prohibiting investment in real estates and in movables is nothing but a constriction imposed on Islamic banks, which leads to their losing the opportunity of investing therein.[1]
Accordingly, the Islamic central bank can take into consideration the special and distinctive nature of the Islamic banks, allowing them to invest in such real estates, movables and activities but within determined terms, conditions and restraints.

d- Pricing of banking services: pricing of banking services means the laying down, by the conventional central banks, of a unified and agreed upon tariff pricing the services rendered by the member-banks. The tariff would determine the rates of interest, discount, commissions, duties and such other denominations.
According to the Islamic banking system, the interest rates and the discount rates are nothing but banned usury. Therefore, they are not used under the Islamic economic system. As for the rates of the other banking services, and in case they are amongst permissible services (meaning juristically and canonically permitted on basis of one of the religiously lawful contracts, such as agency, or lease and tenancy or remuneration or others) then it is permissible to charge fees on, and consequently determine a rate thereon against the effort and time dedicated towards their preparation, dispatch and checking up, also as a price for the paper and stationery used for the completion of the respective work. These rates must be set up on basis of the actual cost incurred by the bank in relation to performing the service rendered in approximation or at the same similar rates prevailing on the market, which would lead to achieving justice and fairness in the calculation of the fee.[2]

e- Preconditioning of insuring deposits: Under an Islamic banking system, all the units and entities thereof are Islamic, it is a must to find an Islamic substitute for delivering insurance on the deposits, in such a way that the insurance process would not be set up on a commercial basis, but on a reciprocal responsibility basis. Thus, it would be possible to lay down a system for the protection of the investment deposits funds against the

---

1 Kamel, Saleh Abdallah, *Islamic Banking Activity and the Control Role of Central Banks*. a research presented to the Islamic Banks Seminar. The Fact and Practical Application, Amman (Jordan): December 1988, p.5.

2 Abou Ghouddah, Abdul Sttar, *Decisions of the legitimate committee of al barakah group*, Jeddah (Saudi Arabia): Publications of Dallah Al barakah group, 2003, p.245.

probabilities of the drop in their original or principal value, without prejudice to the Islamic legislative rules on which are based the speculation contract. Some Islamic intellectuals suggested to set up a central Fund for this purpose under the supervision of the central bank, with the participation of Islamic banks and Islamic branches, at certain determined shares which would be halved between the depositors and the shareholders (the bank), in such a way that the share of the shareholders would be a reserve to face modification probability, and the depositors' share as a reserve to face other probabilities which Islamic legislation stipulates that they should be charged with.[1]

(3) DETERMINING THE CHANGES IN LEGAL STATUTES:

The change in legal status means any change which may occur in the legal existence and form, as well as in the material existence, on basis of which the bank was previously registered, such as the changes in the increase of the capital of the bank, or reducing it, opening new branches, closing outstanding branches, merger operations with other banks and companies, the purchase or sale of banks, their bankruptcy or their liquidation, in addition to any changes in the articles of association, which may lead to the addition of a certain activity, or the stoppage of another activity. Most banking legislations have heeded the laying down of the suitable and adequate checks and restraints which would secure the remedying of any changes which may occur in relation to the legal or material status of the bank, or to its articles of incorporation, after inception of operations, due to the importance of this issue and due to the importance of those such changes, and in order to avoid any complications or differences which may occur in the future. Therefore, we shall deal, hereunder, with the most important aspects of these changes according to the conventional and Islamic banking points of view.

a- Increase and decrease of the capital:

The capital has basic functions in banks, as the financing of the foundation process, the purchase of the major part of fixed assets, and the making available of the necessary limit of the working capital. That is why; it has become important to necessarily determine the amount of the capital when founding the banks. The resolutions related to the increase or decrease of the

---

1 Ibid, p.333.

capital is considered amongst the key and grave resolutions in relation to any bank. That is why we see that most banking systems have promulgated those laws and legislations which would organize and regulate these issues, so that they would not be subjected to hasty, unstudied decisions. The responsibility of ascertaining the extent to which the capital is adequate to the size of the bank's operations falls upon the banks control entities in the central banks. That is why the central bank must always heed the principle of the sufficiency of the capital and equity, in order to face the risks, which may occur. The importance of the capital increases in Islamic banks, more than in conventional banks, in view of the distinctive nature of Islamic banks, and especially in relation of the high degree of risks of their operations.

Furthermore, the increase in the volume of deposits and the consequential increase in the volume of operations, dictates it upon the Islamic banks to increase their capital from time to time, in order to face this expansion in the volume of deposits or operations, and in order to achieve equilibrium and balance between equity and the remaining resources. This has actually taken place in the Egyptian Islamic Faisal Bank, which increased its capital several times, from eight million Dollars to one hundred million Dollars throughout 9 years, with that having been done by most Islamic banks. The officials in charge of the central banks must understand this distinctive nature of the Islamic banks, by facilitating the increase process of the capital of those banks when needed. As for the issue of the reduction of the bank's capital, that process must be subjected to an ample and careful study, so that the bank would not decrease its capital unless there is a dire need for that, as adopting such a resolution may result in the loss of trust in those banks, and shunning from them, which may cause some problems and disturbances to the country's banking system.[1]

b- Expansion or shrinkage in the number of branches:

When a bank opens new branches, this should result in an increase in the activity of the bank, and an increase in its turnover. On the other side, if the bank closes some outstanding branches, this would stand as shrinkage in the activity of that bank and in its turnover. That is why banking systems precondition it to all

---

[1] El Rabi'ah, Seoud Mohamed, *The Conversion of a Usurious Bank into an Islamic Bank*, vol.2, op. cit., p.332.

member-banks therein that they would comply with determined criteria and restraints which govern this operation, and guarantee the approval of the central bank as to such procedures, so that their reference would not be mere personal interpretation and guesstimates.

c- Merger operations:

In view of the risks that are involved in the Merger operations between banks, and which may lead to affecting the rights of some parties concerned amongst shareholders, depositors, and others, the monetary authorities heed that the merger operations between banks would be disciplined and determined, while being subjected to accurate analysis by the responsible authorities at the central bank to identify the real positions and motives of the banks applying for merger, together with the suggested evaluation methods of the assets and liabilities, and the impact thereof on all parties concerned amongst shareholders, depositors and others. Inter-bank merger operations rarely occur, for they are very special and limited cases. What applies to the conventional banks in relation to merger also does to Islamic banks. However, the merger operation according to Islamic economic systems, is nothing but a sale operation. Therefore, there must exist therein those general checks related to the sale contract in Islamic legislation, in exclusion of deceit, ignorance and exploitation or abuse. In the banks' assets evaluation process, the Islamic accountancy principles must also be taken into consideration. Hence, merger is a sale operation which takes place between the purchasing bank called the (acquiring bank) and a seller bank known as the (acquired bank) with each one of the two banks having a certain value.[1]

d- Stoppage of activity and liquidation:

Activity may be stopped due to bankruptcy or due to the wish of the owners of the bank, or due to the expiry of the duration of the lifetime of the bank. Under all circumstances, central banks heed that such a liquidation and stoppage of activity would not take place except after making sure that the bank has been definitely discharged against its creditors, depositors and others. Then comes the liquidation of the rest of the assets amongst the other lenders, with the bank thereafter being deleted from the register of the member banks. The position does not

---

1 Ibid, p.357.

differ much in the case of Islamic banks, except from the nature of the relationship of parties with the Islamic bank upon liquidation. For the holders of the investment accounts will be treated as is the case of the shareholders. They will not get back their rights and profits, if any, except after the full payment of all debts due to creditors, and to the holders of current accounts. Under any banking system, if the bank authorized to practice its activity violates its own articles of association, then the central bank would interfere to penalize this bank, and to redress it. The penalty might reach the limit of stopping the activity or the deletion.

4.3.2 COORDINATING RELATIONSHIP:

By coordinating relationship between the central bank and the Islamic banks, we mean the Islamic central bank undertaking the clearing accounts operations in between the Islamic member banks, in addition to undertaking set-off operations in between themselves. That is why we shall review, in this part, the role of the central bank as to holding and settling the accounts of the member-banks, as well as its role in supervising the clearing operations, and the way in which these operations would be effected according to the Islamic banking system.

(1) HOLDING AND SETTLEMENT OF THE ACCOUNTS OF THE ISLAMIC MEMBER BANKS:

The central bank compels the commercial banks to open accounts in their names with it, in the form of deposits at call (current accounts) and in the form of term deposits, in order to fulfill the obligation of the legal reserve rate imposed by the central bank, and which stands as being a fixed percentage of the total deposits at call and term deposits and saving deposits kept by the depositors with commercial banks. The central bank uses the said reserve percentage as a tool or instrument for the liquidation of the differences of accounts between commercial banks, and which result and originate from the transactions of these banks one with the other by way of using the credit balances of these banks with it. Things do not differ in relation to the issue of the legal reserve rate and the settlement of banks' accounts amongst themselves from part of the Islamic central bank under an Islamic banking system, as long as the central bank represents the ruling or governing authorities, and as long as this technical issue (the determination of the rate of the legal reserve) stands as being of benefit for the Islamic nation, for there is nothing in Islamic legislation that stands against applying the mandatory reserve rate under the Islamic banking system.[1]

Some contemporary economic scientists aroused the subject of the legal reserve rate, and believed that most of the accounts which are opened with the Islamic banks are investment accounts due to the nature of the Islamic banks, and that current accounts only represent a very modest percentage in Islamic banks. That is why they deemed it that there would be no place for discussions or arguments as to the application of the rate of the cash reserve on the current accounts with Islamic banks. As for their application to the investment accounts (joint or allocated), this conflicts with the nature of these accounts, as investors deposit their funds with Islamic banks to invest them on their behalf, bearing, to that effect, the consequences of this investment in terms of profit or loss, and accepting the risk that such investment involves. For the Islamic bank here is a trustee over these funds and is not a debtor thereof. That is why the application of the rate of legal reserve means the deduction of part of the funds of these investors (10% more or less as determined by the monetary authorities) as a reserve, and the investment of the rest of the funds in investment operations. This will mean a tie-up of part of these funds away from investment without consideration for the wish or will of the investors, thus leading to these depositors earning returns which are less than those they deserve, whereas they would simultaneously bear the loss in full. Therefore, some Islamic economists believe that the investment accounts should not be subjected to the cash reserve rate, and that in case of their having to be subjected thereto, then this should not be according to the rates applied to the term deposits with the conventional banks, but at lesser rates. Some central banks have agreed to this request. For example, the Jordanian central bank has exempted Islamic banks from taking a cash reserve on the allocated deposits.[2]

---

1 El hindi, Adnan, *Islamic Banks; the relationship between central banks and Islamic banks*, publications of Union of Arab Banks, Beirut, (Lebanon), 1989, p.31.

2 Kamel, Saleh Abdallah, *Islamic Banking Activity and the Control Role of Central Banks*. op. cit., p.6. and,
El Hendi, Adnan, *Central Banks and Islamic Banks*, The Fact and Practical Application, a research presented to the Islamic Banks seminar, Amman (Jordan): December 1988, p.11.

The contemporary Muslim scientists have studied the position of this deducted rate as a legal reserve. They deemed that it would be much preferable not to allocate profits thereto at all, on the assumption of its not being invested by the Islamic banks. For it is like the funds deposited with them uninvested. Therefore, no share of the profits should be consecrated thereto as long as it is not included in the investment process.[1]

Accordingly, the researcher deems that it would be possible to apply the rate of the legal reserve on the deposits with Islamic banks as long as this operation is considered a methodical and regulatory process in which public welfare and benefit would be realized, and would protect some of the depositor's rights. We also deem that it would be preferable not to allocate profits for this rate which is retained as a legal reserve, as long as it has not been included in the investment operation. Thus, if the legal reserve rate imposed is 10% for example, the profits would then be calculated on 90% of the investment deposit. As for the remaining 10%, no profit would be granted thereupon. The depositors must be informed of that when entering the investment operations, with a declaration as to their approval being taken from them. As for the use, by the central bank, of the percentage of legal reserve for the settlement of the banks' accounts with it, we see no religiously legal obstructions from the standpoint of religious legislation, as long as it is empowered to do that by these banks, and as long as it charges the credit accounts of those banks for the settlement of their accounts with the other banks. It is a precondition that this operation would not involve charging any interest to the Islamic bank concerned if its account has been overdrawn for one reason or another with the central bank as a result of that settlement operation. Therefore, the Islamic central bank must always upkeep and retains the legal reserve rate which is sufficient for the protection of depositors' rights, while at the same time allowing the undertaking of the settlement operations of the banks' accounts, one with the other. If this rate would drop below the limit required, the central bank would directly interfere with the bank concerned, requesting it to feed

---

1 Rabwi, Mohamed Ibrahim, *The Central Bank under the Islamic Banking System*, a research presented to the first deliberation circle about paving the way for the completion of the provisions of Islamic legislation in the economic field in Kuwait, Kuwait: February 1993, p.9.

its account with the central bank in order to upkeep the limits of this rate.

(2) SUPERVISION OF THE CLEARING OPERATIONS:

The central bank renders an important service to the banking system, which is its supervision over the clearing operations between banks. It sets off and liquidates the cheques which banks receive from their customers with the aim of depositing them to their accounts from the other banks. It also settles the various balances throughout lodging some accountancy entries in its ledgers in order to arrive at the final balances of the banks' accounts with it, whereas the value of the cheques drawn on any one bank is cleared in the clearing house, with that of the cheques delivered to it for collection from other banks, in such a way that, at the end of the said clearing operation, there would only be a payment of the left-over balance after clearance in favour of one bank or the other. This operation has several advantages reflected upon the banks, of which that it helps these banks to avoid effecting single settlement and clearing operations in between them, with the problems or loss of time and effort which may result therefrom, in addition to lessening the use of money in the settlement of banking operations. The central bank also resorts to the balance of banks formed by the legal reserve for the settlement of the differences which result after effecting the clearing operations in-between banks, with the daily clearing differences being settled in between banks by credit and debit entries to their accounts with the central bank. If the result and outcome of the periodical final clearing would show that bank (X) is in debt to bank (Y) for a certain amount, then the central bank would resort to the balance of bank (X) of the legal reserve, and would transfer it to bank (Y) to complete the clearing operation. Since this operation achieves public interest, and facilitates inter-banks dealings, saves time and effort for them, and does not conflict with the teachings of Islamic legislation, therefore, it is possible to adopt it under an Islamic banking system. However, there must be a warning against calculating any interests on the banks whose accounts are overdrawn in favor of other banks, if, for one reason or another, it would be impossible to pay the debit balance from the legal reserve of the debtor bank. In case there is a calculation of interest, this operation would become banned from the viewpoint of Islamic legislation, for settlements and clearing operations in between banks must take place away from the use of interests, even if the account of one of the banks would be overdrawn in favor of another bank.[1]

To avoid the calculation of interests on these operations, Islamic banks could conclude an agreement in between them, wherein fixation would be made of the excess duration and limits. If the debit balance would exceed the authorized limit thereof, and the duration fixed for payment, the Islamic central bank would then withdraw the amount of this balance from one of the accounts of the debtor bank opened with the central bank, and feed the account of the creditor bank therewith, or it would be possible to have direct recourse against the debtor bank, and force it to repay the debit balance. Undoubtedly, the overdraw of the account of one bank in favour of another bank only occurs rarely in the central bank. The balance of the legal reserve of banks has to be checked on daily basis in order to ascertain and update the quorum by the central bank. If the balance of the legal reserve of one of the banks would drop below the authorized limit, the central bank would then request this bank to increase its legal reserve balance. This legal reserve is used for the settlement of differences between banks accounts. That is why it is rare that the account of one bank would become overdrawn in favor of another bank, with the central bank being then unable to eventuate and find the balance which would enable it to effect the settlement of the accounts of the banks in between them. It is possible to develop this modus operandi, after practically applying it, and get rid of the shortcomings and problems which may stand in the applied course thereof.[2]

4.3.3 LENDING AND FINANCING RELATIONSHIP:

The conventional banking system is based on the conventionally known methods of financing, which lean on the two lending and borrowing cornerstones, against the interest rates due on these operations. The banking interests rates have imposed themselves on the conventional banking systems, and infiltrated into the banking legislations. Economists believe now that the interest rates are now the basic pivot around which revolves the science of economy,

---

1 Abdul Kadir, Mohammad Razif, *The Role of the Central Banking in the Policy,* Regulatory and Supervisory Framework of Islamic Banking in Malaysia, op. cit, pp.13-14.

2 El Hindi, Adnan, *Islamic Banks; the relationship between central banks and Islamic banks*, op. cit., pp.27-30.

and without which economists could never believe a continuity of the economic activities. Yet the Islamic economic system had proved the nullity of those calls, and evidenced that the interest rates have bad effects on economy, which led several economists to reconsider the policy of the interest rate, and its negative effects on the economy.[1] The philosophy of Islamic banks refuses the financing system by lending and borrowing against interest rates, and considers it a usurious system. If we suppose that there would not be a borrowing without a counter return, then we shall inevitably grant that the lending and borrowing system shall be definitely cancelled from the Islamic banking system. This is something which we cannot conceive in practical life. For lending and borrowing are nothing but ways and systems existing to facilitate transactions between different parties. And since every one party tries to gain those returns which would secure his survival and the continuity of his activity, therefore the lending and borrowing operation without return cannot be a solution, and we cannot conceive it to exist in the economic system. For if most banks would learn that there would be no return against lending their funds to third parties, they will refrain from that lending operation and the sufferance of risks. Even if the loans are soft loans, without any counterpart, they shall be within a very limited range, and the different parties will find and create themselves the excuses and pretexts, in order not to lend. That is why it has become a must for Muslim economists to create a method which would guarantee for the lender to earn a return against his lending, subject to this method being authorized in accordance with the Islamic legislation. Therefore, Muslim economists have found that the Islamic financing and investment methods stand as being a system which could be relied upon to effect Islamic lending and borrowing operations.

Accordingly, the financing by the Islamic central bank of all the member-banks must be set up on the principle of Islamic speculation so that the relationship between the Islamic central bank and the member banks would be on basis of investment and not borrowing. The central bank can provide the necessary funding and financing for the Islamic banks throughout new instruments which were suggested by some Muslim economists such as the central lending certificates, and the alternative policy for rediscount,

---

1 El Khalidi, Mahmoud, *The Capitalism economic in the view of Islam*, Beirut (Lebanon): Dar Al Jeel, 1984, p.35.

and which we shall deal with later on, in addition to the principle of the soft non-interest-bearing loans if possible be dealt in. The central bank can also provide financing required for Islamic banks on basis of the participation or sharing principle and system, wherein the central bank, as provider of the financing, and the Islamic bank as recipient of the financing, enter together as partners in a certain investment operation.[1] We shall deal hereunder with the instruments and methods which the Islamic central bank can use in the lending and financing of the Islamic member-banks.

(1) FINANCING THE ISLAMIC BANKS THROUGH THE LENDING METHOD:

It is a well-known fact that the central bank is the last resort lender of the other banks. In playing this role, the conventional central bank provides the banks with the funding and financing they need mostly in the form of short-term loans, or in the form of the rediscount of commercial papers or bills of exchange against pre-determined interests. However, according to the Islamic economic system, the banning and prohibition of the banking interests dictate the necessity of finding out a lending substitute as a financing method from part of the central bank, for the other banks, in case of their need for liquidity. As we known, the central bank, under the conventional system, provides the required liquidity either by way of discounting the commercial papers or bills of exchange (drafts and the like), as is customary in England, or by way of lending as is customary in the United States of America. And since these two methods are unacceptable under a non-usurious system, therefore, the Islamic economists have suggested legitimate methods according to Islamic legislation which would serve the same purpose. Hence, there were several attempts from part of the Islamic banks to overcome this problem. Sometimes, the Islamic banks tried to create in between them some sort of cooperation and assistance, in case either one of them would be exposed to certain circumstances which would compel it to require more liquidity. In such an eventuality, the remaining Islamic banks would then assist it. Yet, the application of this specimen to practical life, found confronting technical, legal and administrative difficulties. Sometimes, Islamic banks resorted to freezing a fundamental part of their resources to face any

1 Siddiqi, Mohammed N., *Researches in Islamic Banking*, Jeddah (Saudi Arabia): Published by Islamic Economic Center; King Abdul Aziz University, 2003, pp.211-215

contingent cases. This method meant a tie-up of the investment of a key part of the resources of the bank.[1]
Attempts are still under way from part of the Muslim economists till the problem is solved definitely and decisively. Because of that, we deem that there are new methods and instruments which could assist in finding the religiously legitimate alternative for financing by the central bank. Amongst these alternatives are:

a- That the Islamic central bank would set up a fund in which each Islamic bank in the state would deposit a certain rate of the deposits it has (5% or more for example). In case any Islamic bank needs liquidity, the central bank would provide the required liquidity to the bank which is in need thereof within to limits of maximum double the balance available in the fund, without charging interests, and until the liquidity position of this concerned bank would improve.[2]

b- That the Islamic central bank would provide the needy banks with financing, loans or liquidity, by way of using the bases of Islamic speculation. On basis of that, the relationship between the Islamic central bank and the Islamic banks would be an investment one, not a lending or borrowing one. For the entity that finances and provides the funds is the owner of these funds, and the entity that investment the funds provided is the speculator or the operator. Both parties would be subjected to the application of the rules and checks of Islamic speculation, in such a way as would suit the circumstances of the country involved, and the spirit of the age without deviation or violation of the rules of Islamic legislation. The systems and instructions of the Pakistani central bank contain items related to providing the speculation funds to the commercial banks, after the Pakistani banking system moved into the Islamic banking system.[3]

c- That the Islamic central bank as a last resort refuge and savior would provide the Islamic banks which are asking for liquidity, with the required quantities of money by means of a soft non-interest-bearing loan. This method has been used actually

---

1 Uzir, Mohammad, *Central Banking Operations in an Interest-Free Banking System*, Op. cit., P.8.

2 Ismail, Hassan Mohamed, Islamic *Banks and the Banking System*, a research presented to the banking seminar held by the Arab Banks Union in Khartoum (Sudan): December 1989, p.21.

3 Seddiqi, Mohamed Najat Allah, *Financial Management in Islam*, Amman (Jordan): The Royal Academy of the Islamic Civilization Researches, Albayt Organization, vol.1, 1989, p.53.

in the case of the Kuwaiti Financing House. For when withdrawals increase at the Kuwaiti Financing House, the Kuwaiti central bank rushed into providing the Kuwaiti Financing House with the required liquidity, till it was able to go through its predicament. That assistance process assumed two facets which were in the form of soft non-interest-bearing loans, as well as throughout the dense purchase of the shares of the Kuwait Financing House, which slumped strongly at that time.[1]

d- The central bank could pump in the liquidity required by the Islamic bank by directly entering or by entry through one of its affiliates as a purchaser of part of the shares of the Islamic bank requesting the liquidity, then sell them back later on, so that the profit return would be the due right of the central bank as a shareholder.[2]

e- The central bank could pump in the liquidity required by the Islamic bank also throughout the central bank entering as a purchaser of the shares or issues of outstanding projects at the Islamic bank, which have a known value and an anticipated return, selling them later on to the bank, so that the shares return or any realized profits resulting from the upping of the value of the assets, would be due to the central bank.[3]

In addition to the foregoing, there is a method which some economists called the central lending certificates wherein the Islamic central bank would use the munificent motives of some well off savers, by attracting some of their resources into a charity fund which would be constituted beforehand by the central bank, and which would encompass the resources of these savers to effect lending to third parties by way of issuing the central lending certificates, which are certificates representing rights for fixed amounts of money. The proceeds would be used to lend solvent persons in the future, without any material return for the titulars thereof. They would thus be a trust with the central bank with the possibility of enlarging the lending base to encompass the banking institutions. However, it would be difficult to generalise this instrument and use it on a large scale, since we

---

1 El Hendi, Adnan, *Central Banks and Islamic Banks, the Fact and Practical Application*. Op. cit., p.22.

2 Siddiqi, Mohammed N., *Researches in Islamic Banking*, op. cit., p. 218.

3 Ibid, p. 219.

believe that it stands as a limited instrument, and which would not remedy the problem which we are tackling radically, as it realizes on charitable individuals whose whims and moods may change throughout time. Therefore, though it is a method for the lending of individuals, we believe that it would be the solution as far as banks are concerned. However, it could participate, even though on a limited scale, in providing some liquidity for lending to Islamic banks.[1]

(2) FINANCING OF THE ISLAMIC BANKS THROUGH ON PARTNERSHIP BASIS:
On basis of the special and distinctive nature of the Islamic banking system, a new financing relationship between the central bank and the Islamic banks could be created. Through this relationship, the Islamic central bank would finance the banks requesting liquidity by way of using the basics of participation or sharing by means of the central deposits method. The central deposits method is a newly originated method suggested by an Islamic economist, for the purpose of financing the Islamic banks, and for the achievement of equilibrium and balance in the quantity of money in society.[2] The central deposits are investment accounts, which the central bank opens with the Islamic banks. It would then credit its money issue and withdraw what it wants, according to the demand for money circulated on the market. The central bank can eventuate equilibrium and balance in the quantity of circulated money on the market by feeding its investment account with the bank requesting liquidity, and would withdraw part of its investment account held with another bank, or the availabilities of monetary liquidity it may have in its vaults. The Islamic banks would invest the investment deposits of the central bank in the production sector, in such a way as would agree with the investment policy adopted by each and every bank. If profits would be generated on these deposits, it would be possible to use part thereof for expenditure on the operations of the central bank, and part for lending the government whenever needed, or for re-investment in the same way. The central deposits could have two kinds:[3]

---

1 El Jarhi, Mo'obad, *Towards an Islamic Monetary and Financial System*, op. cit., p.41.

2 Ibid, p. 68.

3 Ibid, p. 69.

a) General central deposits: Being the investment deposits which the Islamic central bank would deposit with the Islamic banks without fixing the field wherein they must be invested, by allowing the Islamic bank to invest this deposit in total freedom in the fields which it wishes to direct them into, in such a way as would agree with its investment policy.

b) Specialized central deposits: Being the investment deposits which the Islamic central bank would deposit with the Islamic banks, while obligating the Islamic banks to have them invested in a certain project or a certain group of projects. It would, therefore, direct the investment of this deposit, as would agree with the monetary policy of the country.

Whenever the Islamic central bank would be using the method of the investment deposits, it would, thus, be achieving the following aims:

1- They could be used as one of the instruments of the monetary policy, throughout which it would control the quantity of money supplied for circulation, by pumping into its investment accounts with the Islamic banks, or by withdrawing the quantity which would achieve equilibrium or balance in the quantity of money offered.

2- They could be used as an instrument and method for the financing of the Islamic banks whenever needed by way of pumping investment deposits into the accounts with the banks requesting the financing.

3- It would be possible, throughout them, to achieve the objectives of economic and social development, especially as regards the specialised deposits, whereas it would be preconditioned to direct them towards investment in specific projects or directions in such a way as would agree with the objectives of the economic and social development in the country.

The central bank would be distributing the investment deposits between the member-banks according to specific criteria determined by the central bank, and in conformity with the requirements of the monetary policy objectives.[1]

Thus, one could say here that using the participation or sharing basis by means of the investment deposits method for providing funding and financing to the Islamic banks is an important and

---

[1] Siddiqi, Mohammed Najjat Allah., *Researches in Islamic Banking*, op. cit., p. 219.

successful method which would, simultaneously, be achieving the objectives and goals of the quantitative monetary policy throughout using the method either increasing or decreasing the investment central deposits, as well as the qualitative objectives throughout directing these deposits to investment into specific directions and projects.

4.4 THE ISLAMIC CENTRAL BANK CONTRIBUTES TO ECONOMIC AND SOCIAL DEVELOPMENT:

The central bank plays a key and important role in the development process, which is one of the most important objectives of Islamic country in general, on basis of the fact that most of them are developing countries that suffer from the drop in their national and individual incomes and revenues, as well as from the drop in the production levels in the various fields of economic activities. Most Islamic countries are developing countries, which suffer from economic regress represented by the misuse of the available resources, whether these resources are human or natural, together with the consequential effects thereof reflected in poverty, recess and regress. Even some of the Islamic countries which are characterized by their abundant natural and human resources have failed to create for themselves an auto-growth modus operandi which emanates from their inside. The development experiments of the sixties of this century in the developing States provided practical proof of the limited results acquired from relying on one wing for development, namely that of economic development, exclusive of social development.

Undoubtedly, the success of the development of any one society depends on the people's belief and faith in it, their response to it, their participation in its efforts, and their harvesting its crops. The economic and social development process, as is known, needs a framework gathering together all the members of society as a whole, so that they would all move towards development.

Islam cares greatly about economic development, since it deals with it as part of a larger and more expansive problem which is the development of man, since the core of the development process in Islam is man himself. That is why development means the development of man, his material, cultural and social environment.

The Islamic central bank is one, and the most important, entity of the country which participates in formulating and implementation of the development plans. The major fundamental part in the implementation of the plans of the economic and social development takes place throughout this Islamic central bank, in view of its being empowered with those authorities and potentials, which enable it to direct and orientate the financial and banking establish such as banks and investment companies to the direction sought by the financial authorities in the country. The Islamic central bank draws the policies and plans of the country to suit the trends of the economic and social development. It then obligates the other banks and financial institutions, when performing their operations and activities, to implement these policies and plans, in such a way as would achieve the targeted economic and social development objectives.[1]

That is why, in this part of our research work, we shall review the definitions of development, as well as the Islamic concept thereof, then we shall identify the objectives of the development policy in Islamic societies, and the role of the Islamic central bank therein.

4.4.1 THE DEFINITION OF DEVELOPMENT:

There are several definitions of development, which concentrated on the aspect of the constitution of capital, and the increase of the production energy of economy. Development is merit stands as being the processes of using the available economic resorts for society to achieve continuous increases in national income which would exceed the rates of the population growth in such a way as would eventuates real increases in the average individual's share in the income.[2]

While other definitions state economic development as: 'the economic development is the group of the economic activities which cause the increase of the productivity of economy as a whole, and the worker in the average, and the increase of the rate of the employed to the total inhabitants, and that it is a continuous process which includes structural changes which lead to the improvement of the performance of economy both at present and in the future'.[3] And others define development as: 'a dynamic

1 Uzair, Mohammad, *Central Banking Operations in an Interest-Free Banking System*, op. cit., p.28.

2 Afar, Mohamed Abdel Moneim, *Economic Policies in Islam*, Cairo (Egypt): International Union for Islamic Banks, 1980, p. 166.

3 El Shibani, Mohammed Abdullah, *Development and civilization changes*, Riyadh (Saudi Arabia): Dar Alam El Ketab, 1988, p.15.

process, which dictates build and structural changes, which eventuate a fundamental and continuous improvement in the actual and concealed economic performance, which is usually measured by real individual standardized measurements, and which extends for a relatively long time lapse, and whose core lies in enabling a certain people to consciously control its economic environment, which would improve the quality of life'.[1]

It is to be noticed from the previous definitions that they have only concentrated on one aspect of development, which is the constitution of capital, that is to say the increase of the production capacity of economy. Therefore, they are considered a summing up of the theory of capital. However, development in Islam, has meanings and concepts which differ from theirs in western and socialist systems, whereas the prime function of development in Islam concentrates on the development of man, and on directing him the right way and adaptation from the Islamic values and beliefs, and from the economic and social situations, developmental methods which would suit our circumstances and societies.

4.4.2 THE ISLAMIC CONCEPT OF DEVELOPMENT:

The basic principles for the development process in Islam would be represented in the following [2]:

1- That the Islamic concept of development is characterized by globalization. For it encompasses the ethical, spiritual and material aspects at the one and same time. Thus, development becomes, therefore, an objective and constructive activity which has several and numerous material and moral, economic and social, spiritual and physical, separable dimensions.

2- Man is the centre of developmental effort. He is also the core of the developmental process. For development means that of man, and the development of his material, social and cultural environment.

---

1 Burton, Henry J., *Principles of Development Economics*, Englewood Cliffs (USA): Prentice Hall Inc., 1965, pp. 2-3.

2 Ahmed, Khorshed, *Economic Development within an Islamic framework*, a research work published by Islamic Economic Researches Magazine, Jeddah (Saudi Arabia): International Centre for Islamic Economic Researches, 1980, pp.27-32.

3- Economic development in Islam is a multi-dimensional activity. Islam endeavour to set up balance between the different elements and the effective forces in the developmental process.

4- Economic development in Islam requires a number of variants both qualitative and quantitative. Islam aims at achieving balance between these variants so that quantity would not overcome quality. For interest in the kind and the good quality is a fundamental requirement in Islam.

5- Islam has especially asserted two of the effective principles in social life. The first one of these lies in the optimum use of the resources which God has bestowed upon man and his natural environment. The second one being the fair use of these resources, the distribution of all humanitarian relationships and having them improved on basis of right and justice.

Therefore, we can see that the economic development under Islam is an activity that is directed to the goal or objective. It achieves virtue, and dictates the deep and expansive contribution of man. It aims at achieving the maximum limit of human prosperity, and to the building up of the strength and power of the nation, so that it would play its role in the world, that of God's successor on earth, and that of the moderate nation. Development in Islam means the moral, spiritual and material development of the individual and society, towards the greatest socio-economic welfare.

4.4.3 THE OBJECTIVE OF THE DEVELOPMENT POLICY IN ISLAM, AND THE ROLE OF THE ISLAMIC CENTRAL BANK IN ACHIEVING THESE OBJECTIVES:

Through our review of the previous points, it ensues that development in Islam has objectives which the Islamic nation seeks out to achieve. Each and every Islamic country uses several entities in its being for the achievement of those objectives. Amongst these important entities used by the country as an instrument to arrive at the developmental targets stands out the Islamic central bank. For, the Islamic central bank controls a vast space which has an important effect on the events of the economic and developmental variants in society. The objectives of the development policy in Islam revolve around the following:

(1) THE DEVELOPMENT OF THE HUMAN RESOURCES:

This includes the development of characters and personality, and the development of the training, education and pedagogy methods, and the raising of the level of knowledge and research of the production of the qualified individuals who are capable of participating actively in the various production activities, and coping up with development and progress, which occurs in all the activities and instruments used therein. Undoubtedly, the development of the human resources is a fundamental requirement in Islam, which endeavours to achieve and arrive at. It is impossible to achieve any development of the human element unless there is a response from part of the individual and the group. The Muslim individual feels the responsibility thrown upon his shoulders in respect of his nation and motherland. Therefore, he seeks out education, training and more reading and know-how in response to the orders of God and the glorious Prophet Mohammed, and in achievement of the power and independence of the nation.[1]

The Islamic central bank contributes greatly to achieving the required and targeted development of the human factor or element which would assist in the independence of the nation and its self-reliance. In order to achieve this end, the central bank uses several methods, some of which are stimulating and some are intimidating. Amongst its, methods of approach in question, stands its compelling all banks and banking institutions operating within its range and boundaries to train and qualify national youth of national appurtenance for the occupancy of a certain percentage of the posts which are occupied by foreigners, or with the aim of placing the young element instead of the aged and retired one. Therefore, the training and education process in question is nothing but a development of the human element, by increasing its knowledge and scientific qualifications so that this element would be able to cope up with the development and the progress of life. Furthermore, the Islamic central bank can achieve the target of the development of the human element by way of directing the banks which operate within its boundaries, towards granting facilities and loans to the educational and training establishments which participate in the qualification and training of the human factor or element.[2]

The Islamic central bank may resort to directly participating in the funding and financing of the educational and training

---

1 Ziauddin, Ahmed, & others, *Money and Banking in Islam*, Islamabad (Pakistan): Institute of Policy Studies, 1983, pp. 28-32.

2 Tanash, Ahmed Mahmoud, *The Basis of the Economic Development In Islamic Ideology*, Amman (Jordan): Yarmouk University press, 1991, pp.95-101.

establishments, by entering into them as an investor, aiming out of that at the promotion and development of the human factor, regardless of the material returns which it could harvest out of entering into this investment. Moreover, the Islamic central bank can constitute a provision to be deducted from the profits it earns, as against its entry into the financing of several investment projects in the country, in such a way that this provision would be used for the development and promotion of the human resources in the country, by way of providing training and educational scholarships to certain categories of the people, or by way of providing the educational and training entities with the latest educational and training instruments and equipment.[1]

(2) EXPANSION IN USEFUL PRODUCTION:

The increase in production and the continuous expansion are considered major development requirements and vitally important objectives of the nation.

The Islamic central bank participates in achieving this developmental goal or objective by way of directing credit in the country towards investment in the production sectors of use and benefit for the members of the nation and society. That is why the laws of the Islamic central bank and its legislations which obligate the remaining banks and banking institutions include, in core and content, the direction of those banks and institutions towards providing facilities to those who would wish to delve into these aspired production activities. At the same time, the Islamic central bank can impose those restrictions and stumbling blocks capable of deviating and stopping those entities from investing into undesirable and useless fields and activities for the members of the nation and for society. Similarly, the Islamic central bank could enter directly, or by way of one of its entities, as an investor in some production projects of use and benefit for the nation.[2]

As an example of the role of the Islamic central bank in achieving the objective of expanding on useful production, we state here the

---

1 Saudi Arabian Monetary Agency, *Thirty Ninth Annual Report*, Riyadh (Saudi Arabia): Published by Research and statistics Department, Saudi Arabian Monitory Agency, 2003, pp.281-289.

2 Khan, M. Fahim & others, *Fiscal Policy and Resource Allocation in Islam*, Islamabad (Pakistan): Institute of Policy Studies, 1983, pp. 73-74.

modern Egyptian experience to that effect, which lies in the economic authorities in Egypt having conducted a study of the position of the economic market in all aspects and facets, after it was clear to them that there is an increase in the rate of unemployment in society. These authorities resorted to imposing economic policies which had a great effect in the reduction of the unemployment rate. The direct role in relation to the implementation of these policies falls on the central bank which issued its directives and instructions to all the banking entities and systems, stressing on the importance of providing soft loans and facilities to the university graduates under reasonable guarantees, and which would enable them to institute small production projects, whether agricultural or industrial which they would run themselves. Amongst the results of those policies was the increase in production in the field of several activities, and the lessening and reduction of the unemployment levels, and the creation of new job opportunities for other categories of the people.[1]

(3) RAISING UP THE STANDERD OF LIVING:

To achieve a standard of living which would realise moral, economic and social welfare for people is one of the objectives of Islamic countries. The principle of raising the standard of living for the members of the Islamic nation is considered one of the most important cornerstones of the development process in Islam. For the purpose of arriving at an adequate standard of living, it is a must to achieve the following:

a- Create job opportunities which participate in employing skilled labour, qualified labour and even ordinary labour, as well as the creation of functional opportunities which would suit the levels constituting the classes and segments of society. The alms (zakat) stand as being one of the financing sources of the Islamic country upon some of whose appropriations and allocation one could rely for the setting up of useful projects which would share in the employment of workers and employees, and create ahead of them new job opportunities. The Islamic central bank can also participate in this aspect, throughout its undertaking the alms (zakat) collection operations on behalf of the competent

---

1 Mashuhour, Amira Abdullateef, *Investment In Islamic Economic*, op. cit., pp. 39-41.

governmental entities, and identifying those projects in which these funds could be invested.[1]

2- Laying down of a social security system, which would provide security to those who are unable to earn their living, or those who deserve assistance from society in order to get the basic necessities of decent life which would drive them away from begging and preserve their sense of pride. In this system, the alms (zakat) occupy the place of the core.[2]

3- Fair distribution of revenue and wealth, by laying down an income and revenue system by means of which it would be possible to raise the levels of the low income categories.[3]

The Islamic central bank participates in improving the standard of living by achieving the previous principles. When the central bank participates in the expansion of production, it creates new job opportunities. And when it participates in the development and promotion of the human resources, it thus guarantees the creation of qualified and trained labour. Therefore, the orientation by the Islamic central bank of credit towards the activation of certain production sectors guarantees the creation of new job opportunities for several segments of the people, while at the same time securing the raising of their living standards. Furthermore, the Islamic central bank can submit its recommendations and proposals to the responsible economic and political entities in the country as to the suggested form of the social security system which would guarantee the necessities of life for the people. The Islamic central bank can also undertake the collection operations of the alms (zakat) & the charity which stand as being an important source for the Islamic country, for its operating, and for its management in order to achieve and arrive at this objective.[4]

---

1 Islahi, Abdul Azim, *Economics of thought of Ibn Al Qayyim*, Jeddah (Saudi Arabia): Research Series in English, No. 20, International Center for Research in Islamic economics, K.A.A.U., 1984, pp. 8-10.

2 Al Sayed, Atef, *Studies in Economic Development*, Jeddah (Saudi Arabia): Dar Al Majma'a Al Arabi, 1987 [1st. edition], p.57.

3 Al Najjar, Ahmed Abdul Aziz, *Introduction to Economic Theory in Islamic Ideology,* Cairo (Egypt): International Union for Islamic Banks, 1980, p.206.

4 Afar, Mohamed Abdel Moneim, *Economic Policies in Islam*, op. cit., pp. 181-184.

(4) ACHIEVMENT OF BALANCED DEVELOPMENT:

This means the achievement of equilibrium and harmony in relation to the development of the various areas of the one and same country, and the different economic sectors in society. Interest in the industry sector, for instance, does not mean that we would neglect the rest of the sectors (agricultural, servicing or commercial). For address must be towards the achievement of a comprehensive development of all the production sectors whether agricultural or industrial, servicing or commercial, all of which must have their shares of the attention paid by the economic authorities in the country. The Islamic central bank participates also in achieving the balanced development of all production sectors by way of its directing credit towards granting many facilities, loans and privileges to the sectors which the State wishes to invest in.[1]

Here, we must point out the role undertaken by the economic authorities in Saudi Arabia in relation to the achievement of this principle of great importance and vitality, when the Saudi Arabian Monetary Agency hinted it to the Agro-Development Fund that it should provide more facilities, grants and loans to farmers, until they were able to create an agricultural base in a country which was known to be a desert country. At present, this country achieves self-sufficiency in the production of wheat, after having been fully reliant on imports. In addition to wheat, we can see that the effects of this policy have lately been fruitful, to a certain extent that very many of the crops are now being produced locally, with the surplus even being exported overseas. The tendency of the Saudi monetary authorities towards developing the sector of agriculture, after achieving the required stability in the sector of industry, provided the kingdom with a solid industrial base.[2]

(5) TRANSFER OF MODERN TECHNOLOGY:

It is impossible to imagine the achievement of development in a certain society without the existence of modern technology. Islamic countries are asked to work towards the transfer of modern technology into their societies, and to have the members of

---

1 Dunya, Shawqi Ahmed, *Islam and Economic Development*, Cairo (Egypt): Dar Al Fiker Al Arabi, 1979 [1st. edition], p.53.

2 Saudi Arabian Monetary Agency, *Thirty Ninth Annual Report*, op. cit., pp.259-266.

society trained as to the use of this technology above all. The development process will not be self-feeding except after we have become independent from foreign assistance. This is not all; we shall not be able to achieve this except when we shall be in a position to introduce the technological creativity process to our societies, and until we shall start producing that technology which bears the mark of our nation. This requires high degrees of scientific research work, active perseverance and high morale.[1]

The Islamic central bank has its contributions in the transfer of modern technology to Islamic societies, through its role played in relation to the development of human resources, and equipping the scientific research centres with the instruments and equipment they need for the technological creativity process, in line with what we have previously mentioned as to how the Islamic central bank could participate in the development of human resources in this field. Furthermore, the Islamic central bank can also issue its resolutions and directives to the banking entities and systems in the country to facilitate the operation of transferring technology to the country, throughout providing the necessary allocations for that purpose, and by granting loans and facilities which would make it possible to draw benefit from the transfer of sciences and technology to the country.[2]

(6) LIMITING AFFILIATION TO OTHERS:

No nation can achieve self-development by relying on other nations. For, the first condition for the achievement of development is self-reliance. This, of course, does not mean that we would do without others. On the contrary, we should draw benefit from the experience of others in this field, while trying to fully rely on ourselves. Islamic countries could form themselves an economic confederation which would achieve them self-sufficiency. There have been several attempts to achieve this principle by Islamic countries, the practical appliance of which still needs more time and effort.[3]

---

1 Al Najjar, Ahmed Abdul Aziz, *Introduction to Economic Theory in Islamic Ideology*, op. cit., p.203.

2 Saudi Arabian Monetary Agency, *Thirty Ninth Annual Report*, op. cit., pp.275-280, and 287.

3 Abdul Mannan, Mohamed, *Why is the Islamic Economics Important? Seven Reasons for Believing*, Jeddah (Saudi Arabia): a research published by the International Centre for Research in Islamic Economics, September 1982, p. 18.

The Islamic central bank has an important and effective role in achieving economic and social development in Islamic societies. For its role does not rely on the realization of profits, and the control of money and banks in society solely, but it has a more encompassing and comprehensive role, being that of the achievement of comprehensive development for those societies wherein it exists.[1]

4.5 THE ISLAMIC CENTRAL BANK AS BEING THE CONTROLLER OF CREDIT:

The central bank is capable of affecting the volume of credit, and consequently in the volume of banking money. For the function of the control of credit means the central bank's domination of the volume of the quantity of banking money which commercial banks can eventuate, so that the volume of credit in society would cope up with the level of economic activities desired, in prevention of the occurrence of a monetary inflation, or the occurrence of a recession. Credit consists of: a creditor granting a debtor an interval at the expiry of which the debtor would undertake to repay the debt or its value[2]. As for credit, from the standpoint of banking, it is a loan or an overdraft which the bank grants to a certain person.[3] As for the volume of credit, it is the overall amount of loans granted by the banking system.[4] It goes without saying that the fundamental and basic element of the credit operation is the existence of trust. For the creditor's trust in the debtor's ability to repay is the factor that spurs him into granting credit.

Commercial banks participate in eventuating the credit process through their practice of their ordinary lending activities, without need to keep all the amounts they have as term deposits or saving deposits or current accounts. For they retain a percentage of these deposits with them, or with the central bank, while lending the remaining part. Thus, what enables banks to undertake and effect the creation of credit is that they are not usually

---

1 El Masri, Rafiq, Islamic Development Bank, Beirut (Lebanon): Al Resalah Establishment, 1992, p.230.

2 Issa, Moussa Adam, *The Effects of Changes in the Value of Money and How to Tackle Them in Islamic Economy*. Jeddah (Saudi Arabia): Printed and Published by the Development and Researches Department, Dallah Al Baraka Group, 1993 [1st. edition], p.190.

3 Ibid, p.190.

4 Omar, Hussein, *The Economic Expressions Encyclopedia*, Cairo (Egypt): Cairo Bookshop, 1965, p.3.

required to provide a reserve rate of 100%. For in case the reserve ratio is 100%, the commercial banks will never be able to eventuate any credit activity.[1] Therefore, commercial banks in the modern age have assumed the form of institutions which take in deposits from the individuals on the one side, and provide loans to the applicants thereof at a volume that exceeds that of the deposits they take in on the other side, without that affecting their potential to honour withdrawal requests submitted by depositors, as the vaults of these banks will continue to be fed by an inflow of new deposits, in addition to the fact that depositors do not ask for the withdrawal of their deposits in one lot. The commercial bank can increase money supply throughout two ways:[2]

a) Lending the deposits which are over and above the monetary reserve ratio.

b) Opening current overdraft accounts for customers.

Accordingly, if a commercial bank receives a deposit amounting to 1000 monetary units, with the respective reserve ratio being 20%, the commercial bank shall be, then, able to retain the ratio of 20% of the received amount, and which is equal to 200 monetary units. Thus, it will be in a position to lend the balance to third parties or use it to open overdraft accounts in the name of its customers. This remaining amount of 800 monetary units will find its way to the other banks which, in turn, will keep the percentage or ratio of 20% while lending the balance to third parties. This serial sequence will continue and go on until the volume of the principal or original deposit shall disappear or approach to zero or nil. We can identify the volume of money which the banking system can eventuate or create as a result of any depositing process by way of what is known as the credit multiplier. The mathematical equation by means of which the credit multiplier is calculated stands as follows:[3]

The credit multiplier = the original deposit X (1- Legal Reserve Rate) / Legal Reserve Rate

---

1 Nasir, Zakariya, *Money and Credit in Capitalism and Socialism*, Cairo (Egypt): El Medani Press, 1965, p.106.

2 Mohareb, Nabeel Sedrah, *Money and Banking Institutions*, Cairo (Egypt): Dar El Nahdah El Arabia, 1968, p.269.

3 Yossri, Abdel Rahman, *The Economics of Money*, Alexandria (Egypt): Egyptian Universities House, 1979, p.102.

Therefore, the credit multiplier represents the volume of money created or eventuated by the banking system against its receiving of any deposits from its customers. On basis of the information related to our previous example, it would be possible to extract the volume of money created by the banking system throughout the said credit multiplier law, and which equals to:

1000 x (1 - 20%)/20% = 1000 x 80%/20% = 4000 monetary units.

However, the commercial banks' ability to create credit is not absolute. For, in order that banks could eventuate credit in the previous form, an important proviso must be fulfilled, namely, that the new money must be kept and retained inside the banking system. If this money would seep out of the banking system into circulation fields between individuals, or if banks would retain a liquidity rate which is over and above the stipulated one, then the banks' ability to create credit would drop and dwindle. Thus, the credit multiplier equation, which we have previously mentioned, shall have to be reworded by adding the rate of leaks to it, so that the equation would take the following form:

The credit multiplier = the original deposit X (1- Legal Reserve Ratio) / (Legal Reserve Ratio + leaks Ratio)

From the foregoing, we come to the conclusion that creating credit by commercial banks leads to the increase of the methods of payment, and that excessive expansion in credit would increase the supply of money to a great extent, which would threaten and jeopardize economic activity as a whole. For the increase in money supply in the short-term in a way that would not be absorbed by the production system nor interpreted in the form of increases in production, will lead to an increase in prices level, which would mean a drop in the value of money.

What interests us to know here is the ruling of credit under an Islamic economic system, whereas some Islamic economists went to the extent of tabooing and prohibiting the principle of credit under Islamic economy, as the credit operation is based on lending part of the funds deposited with banks to third parties against determined interests. For if these parts of the funds deposited would not be re-lent to others, there would be no credit occurrence. And since commercial banks charge interests against their lending of parts of the funds deposited with them, therefore, the credit eventuating operation in accordance with this modus operandi is not allowed under Islamic economy. Moreover, some believe that eventuating credit has some negative effects which would cause harm to national economy, such as increasing the money supply, and accordingly leading to the increase of prices, and causing harm to those of limited incomes, resulting in shaking the function of money as a measurement of values.[1] Some also deem that empowering the commercial banks the right of eventuating credit, is like agreeing to accept the participation of these banks with the State in issuing and supplying money.[2]

However, the researcher believes that finding an exit for the subject of lending on interest basis could move the credit eventuating process from prohibition into acceptance. The proposed exit to lending on interests by some financing methods which are authorized by religious legislation such as the speculations, profit-sharing and participations, and other methods blessed by religious legislation. If that would be done in Islamic banks, then the credit eventuating process would be authorized and lawful by religious legislation according to the Islamic economic system. As for the negative effects of the credit eventuating process on the national economy, we believe that although these negative effects do exist under the conventional economic system, they are of limited effect under the Islamic economic system. The Islamic banks differ from the conventional banks in relation to creating credit. This is due to the fact that the latter ones expand in credit and go beyond their own resources, relying on the balance of the two withdrawals and depositing currents (which take place daily and continuously); regardless of the inflation that affects economy. As for the Islamic banks, and in view of their distinctive nature and unique characteristics which rely on participations in most of their operations, we see them enter into real production institutions either as partners therein, or owners thereof. This means the existence of a real production activity against any money supply. Therefore, there would be no inflation in the form that could take place in a non-Islamic economy. Even if there would be inflation here, then it will be a benign and acceptable one, within the frameworks that are not harmful economically. For according to that participation and sharing

1 Issa, Moussa Adam, *The Effects of the Changes in the Value of Money and How to Tackle Them in Islamic Economy*, op. cit., pp.192-193.

2 Ibid, p.96.

between the banks and the investors, money will only appear upon the increase of productive activity.[1]

Furthermore, the entry of the Islamic bank, whether as partner or as financier of any economic projects is only done after completion of the feasibility study related thereto fully and comprehensively, after being sure in anticipation that this such project shall have good results from the standpoint of the investment return for the investors, and from the standpoint of the increase of the real production activity of the country as a whole. This, in itself, is considered a fundamental and basic determinator of the volume of credit under an Islamic economy. There is no doubt that the credit creation and eventuating process is an important and necessary operation in any country, especially in the developing countries wherein there are not enough savings which would enable them to finance the economic development process.[2]

Accordingly, we can see how credit is very important for economic life under an Islamic economic system. For credit helps in the preparation of the sufficient funds, whether as concerns the producers or the speculators under the Islamic system, and puts these funds within their reach when venturing in production operations. Similarly, credit helps in the increase of the volume of the economic activity much more than in case dealing would be throughout real money only. That is why we believe that the neutralization of credit under Islamic economy will sentence economic activity in Islam to permanent shrinkage, in addition to being instrumental in society losing many benefits which it could have harvested. Out of all of the foregoing, the researcher does not agree with some writers about Islamic economy, who request that the legal reserve ratio in Islamic banks should be equal to 100%, so that these banks could not expand on credit on pretext or

---

1 Abdel Rassool, Ali, *The Creation of Credit in Commercial and Islamic Banks*, Cairo (Egypt): an article in Islamic Banks Magazine, International Union for Islamic Banks, Rabee' El Thani, 1401 H., pp.34-35.

2 Nasir, Zakariya, *Introduction to the World Bonds Markets*, Kuwait: The Economic Development Kuwaiti Fund, 1979, p.33. Also: El-Sayyed Ali, Abdel Moneim, *The Role of Monetary Policy in Economic Development*, Cairo (Egypt): Arabic Institute for Researches and Studies, 1975, pp. 50-51.

allegation of achieving a greater part of stability in the prices level, and in the value of money.[1]

Furthermore, the researcher does not agree with some other writers who call for a certain percentage of the Islamic banks as non-credit-eventuating banks, namely banks for investments and services wherein the reserve ratio would be 100%, with other banks being state-owned called credit banks, controlled by the government, which would also control, to a great extent, their credit expansion potentials. For the existence of such banking specimen suggested by some will face technical and religiously legislative hazards and perils which will stop in the way of their operations when applied to practical life.[2] The researcher even agrees with the conclusions arrived at by Moussa Adam lssa, in his book The Effects of Changes in the Value of money and How to Tackle Them under Islamic Economy, when he dealt with the topic of credit creation by Islamic banks, authorizing and encouraging it because of the following reasons:[3]

1- That the nature of Islamic banks is based on participation and sharing instead of lending. This limits the Islamic banks' power to eventuate credit.

2- That the credit eventuated by the Islamic bank differs from the credit eventuated and caused by the commercial bank. For the Islamic bank spends on the projects after studying its economic feasibility, which means that the aspects of credit differ in some scopes between the usurious system and the Islamic system.

3- On basis of the two previous paragraphs 1 and 2, the Islamic bank actually participates in production. Therefore, the credit money it issues appears with the emergence of production, disappears with the consumption of production, for it to go back, once more, to the Islamic bank, while real production remains equal to the volume of credit, without any effect upon the prices levels.

Due to the importance of the subject of credit as eventuated by the Islamic banks, commercial banks and financial institutions,

---

1 El Jarhi, Mo'obad Ali, *Towards an Islamic Monetary and Financial System*, op. cit., p.35.

2 Ali, Ahmad Majthoob, *The Economic Policy in Islamic Economy*, M.A. Thesis, Mekkaha (Saudi Arabia): Islamic Legislation Faculty, Om El Kora University, 1983, p.233.

3 Issa, Moussa Adam, *The Effects of Changes in the Value of Money and How to tackle them in Islamic Economy*, op. cit., p.198.

and the effect and impact thereof on economic life, we have consecrated it a special chapter, in which we shall review the criteria of banking control on credit, both quantitative and qualitative, in addition to the direct control criteria under the Islamic economic system, while also reviewing therein the religiously legitimate control in central banks, and the role thereof under the Islamic economic system.

CONCLUSION:

The functions of Islamic central banks are divided into two major parts. The first concerns the control of banks and financial institutions and the organization of their operations, while the second deals with the control of the supply of money with the objectives of the monetary policy of the country. It has been proven in this chapter that the Islamic central bank can practice many traditional functions which do not conflict with the Islamic Shariah. It can also practice the remaining functions which are considered contradictory to the Islamic Shariah after introducing some amendment and modifications. So in this chapter we have reviewed in detailed the Islamic definition of money, and the issue of money in the Islamic country, as well as the most important and key provisions of Islamic legislation related to the issue of money, in addition to the rules of money issue under Islamic economy, and the placement of the new issue by the Islamic central bank.

Therefore, the function of the Islamic central bank as money issuer is analyzed, it became clear that the management and organization of the money issuance is based on rules and bases which must be heeded, and must not be neglected, of which stand the following ones:

a) That money is divided into money by creation or nature being gold and silver, and money by usage and conventionally, being the other metallic mints and the like such as is the case of banknotes.

b) That the paper currency is a self-existent currency, which encompasses the ruling provision of gold and silver.

c) Paper money is considered as assuming several kinds which vary according to the issuing entities in the different countries. For the Saudi paper money is one kind, and the American paper money is another kind.

d) The money issue operation is only the competence of the Moslems' ruler, with nobody else being allowed to do this. The Moslems' ruler has the right to delegate this task to a certain determined entity or trustworthy persons who are reputed as being honest and unbiased.

e) The existence of quantities of gold, silver and foreign currencies with the Islamic central bank represents a support and strength factor for the local currency, and also for the stability of national economy.

f) The Islamic central bank's method of placing its new money issue for circulation relies on two ways being lending to the government and the Islamic banks, or participating with the Islamic banks.

As for the discussion moved to the second function of the Islamic central bank, which concentrates on the relationship between the Islamic central bank and the government, and wherein we made clear the assignments and tasks undertaken by the Islamic central bank on behalf of the government, amongst which are the receipt of the revenues of the country and the payment of its expenditures, and the management of the country's foreign currency assets, and the regulation of the country's public debt, in addition to its role as the financial and monetary counselor of the government, as well as the lending of the government and its financing and funding. As for this function it is concluded that the Islamic central bank undertakes all the financial operations needed and required by the country or by any of its entities, as it is considered the treasury of the government. It also manages the balance of the country's assets in terms of foreign currencies and precious metals, and plays the role of the financial and monetary advisor or counselor of the country. The Islamic central bank undertake the responsibility of the management and the organization of the country's public debt, whether in the form of loans to the country from part of individuals or institutions or authorities within the boundaries of the country, or outside it. Under the Islamic economic system, the conventional forms and shapes are replaced by Islamic bases and methods. And finally, the Islamic central bank is the financier and lender to the government whenever it might need such loans. It finances the government throughout the method of short-term soft interest-free loans, or by medium and long-term loans according to the Islamic contexts approved and authorized by

Islamic legislation, under specific terms and conditions and according to certain agreements.

Then, with regard to the Islamic central bank's function which concerned the organization of the relationship of the central bank with the other operating banks is studied and reviewed. It concluded in this part that the relationships between Islamic central bank and the other banks have been divided into three key organizational, coordinate and financing relations. As for the organizational relationships, they are concerned with the probing into the legal issues connected with the foundation and operating of these banks in addition to any changes which may occur to their legal status and existence, such as expansion, shrinkage or even liquidation and closure. Whereas the coordinate relationship is interested in the subject of the central bank's holding of the ledgers of the member banks, and the settlement of their accounts with it, and its undertaking clearing operations in between the member banks. As for the financing, or lending relationship, we identified through it, those methods and ways to which the Islamic central bank resorts to in the financing and lending of the member banks.

Furthermore, it is shown in this chapter that the Islamic central bank plays a key role in achieving economic and social development. It has an important position for monitoring and controlling the credit in the society by using special tools and instruments designed and modified in accordance with the Islamic Shariah.

CHAPTER 5

CREDIT CONTROL IN THE ISLAMIC CENTRAL BANK

INTRODUCTION

Credit control, whether under the conventional economic system or under the Islamic one, aims primarily at controlling the quantity of money in the market and the fields that it utilises in.

The central bank uses the quantitative banking control criteria to affect the volume of credit created by the commercial or Islamic banks. The central bank may also resort to using the qualitative banking control criteria to control the quality of credit provided by banks and influence its use. It directs credit towards a certain sector or various economic activities in light of the aspired economic objectives and priorities included in the credit policies which the central bank works to get implemented.

Therefore, we shall review here the quantitative and qualitative banking control criteria in use by central banks at present and look at the standpoint of the Islamic Shariah. We will discuss the criteria which are in agreement with the Islamic Shariah and those which contravene it or those which would be subjected to review, while attempting to find Islamic substitutes. We will also tackle the direct control criteria over credit from an Islamic perspective, also dealing with the issue of legitimate control under the Islamic banking system.

5.1 THE QUANTITATIVE BANKING CONTROL INSTRUMENTS FROM AN ISLAMIC PROSPECTIVE:

The quantitative banking control aims at controlling the volume of credit. It affects the credit movement by either increasing or decreasing it or by stabilising at its first level, regardless of the aspects in which the credit is being used. Usually, central banks use several criteria and instruments which enable them to achieve their objective. Here we shall deal with each one of these criteria through an analytical approach and from the Islamic perspective.

5.1.1 LEGAL RESERVE RATIO:

Legal reserve or what is known as cash reserve rate is that percentage of the customers' deposits which the commercial banks are system-bound to keep in the central bank[1].

The basic objective of the application of the cash reserve policy stands as follows:

a- Defending the depositors' rights with commercial banks by securing a minimum limit of liquidity available with these banks, and having it deposited with the central bank to face any contingencies which may dictate the refund of the depositors' money to the rightful owners.

b- Influencing the commercial banks' potential as to eventuating credit and keeping the safety of the credit conditions in the country.

(1) THE MODUS OPERANDI OF LEGAL RESERVE POLICY:

The legal reserve policy works by controlling and directing the credit through the central bank's fixation of a certain percentage of the assets and deposits of commercial banks in such a way as to dictate having this percentage kept with the central bank. This means that part of the liquidity of commercial banks is retained with the central banks.[2]

In times of recession, the central bank resorts to reducing the rate of reserve which commercial banks must keep with it. The central bank releases some cash balance, increasing the capability of commercial banks to grant more loans. This assists in the increase of the quantity of payment methods

---

1 El Masri, Sameer, & Hussein, Salah El Dine, *The Economics of Money and Bank*, Jeddah (Saudi Arabia): Okaz Printing and Publishing House, 1980, p.137.

2 Goldfeld, Stephen M., & Chandler, Lester V., *The Economics of Money & Banking*, New York (USA): Harper & Row Publishers, 1985, PP.260-264.

in society and the motivation of transactions. This, in turn, leads to an increase in overall demand, whether consumable or investment, which will eventually lead to the increase of the national income.

Contrary to that, we find that in case of inflation the monetary policy is directed towards undertaking all adequate procedures to limit escalation in prices. That is why the central bank resorts to raising the rate of the cash reserve to limit the commercial banks' capability to grant credit. The commercial banks will be compelled to increase the quantity of their cash reserve in the central bank up to the limit which would match the requirements of the new reserve rate. As a result, commercial banks will be forced to temporarily limit the granting of credit. This would help reduce the overall demand for commodities and services and consequently the price level[1].

We must point out here that any change in the percentage of the legal reserve will increase or reduce the offer of money at a rate equal to multiples of the amount of change in the legal reserve rate as a result of the effect of the credit multiple. We can ascertain the volume of the money which the banking system could eventuate through any depositing operation by means of the equation of credit multiple[2]:

The credit multiple = the original deposit X (1-Legal reserve rate) / Legal reserve rate

In this respect, we would like to state how to identify the legitimate adaptation of the cash reserve and the analysis of this rate from an Islamic banking perspective.

---

1 Seigal, Barry N., Siegel Barry, N., *Money, Banking and Economy, A Monetarist View*, New York (USA): Academic Press, 1982, pp.268-270.

2 Yosri, Abdel Rahman, *The Economics of Money*, Alexandria (Egypt): The Egyptian Universities Printing House, 1979, p.102.

(2) THE ANALYSIS OF THE CASH RESERVE RATE FROM AN ISLAMIC BANKING PRESPECTIVE:

Central banks compel the commercial banks and all the deposit-taking institutions to deduct a percentage from their deposits to be kept in the central bank without granting them any interest or financial return on that deducted rate. This rate changes and differs from one country to another. This rate may also change according to the kind of deposits and their maturities. The central bank lays down an accurate system for the determination of that rate and its continuous changes. This rate plays an important role in monetary policies on the basis of it being an effective instrument used by the central bank. Through this rate, the central bank can relatively control the lending capacity of the banking sector, and consequently control the volume of credit. By having a look at the legal reserve rate and the objectives aimed at, we shall find that this rate is legally classified as being one of the following three aspects[1]:

i. Either to consider this rate as a deposit with the central bank.
ii. Or to consider it as a pledge with the central bank
iii. Or to consider it as a loan to the central bank.

The researcher considers that the deducted rate, which is deposited with the central bank, is nearest to being a loan because of the following reasons:

(a)- It agrees with the legitimate terms and conditions controlling the loan. The loan, as legitimately seen by the Islamic Shariah, is money paid to whoever shall use it and

1 El Tamimi, Yehya M. H. S., *Towards an Islamic Central Bank*, Mekkah (Saudi Arabia): Om El Quora University, The Faculty of Islamic Legislation, M.A.thesis, 1987, p.176.

benefit from it, in sympathy therewith, with its substitute being refunded.[1]

This is what applies to the legal reserve rate. The central bank stands as the borrower to achieve public welfare by keeping the money supply stability and at the same time protecting the depositors' funds in commercial banks. This loan would, thus, become mandatory for the achievement of public welfare deemed by the Muslim ruler. The cash reserve amount is lodged on the credit side of the account of the commercial bank with the central bank. The central bank is entitled to use these funds or to have them lent to the government, while being obligated to refund the substitute to the commercial bank. This confirms these funds being lawfully considered as loans, according to the Islamic Shariah.

(b)- The rate of the legal reserve cannot be considered from the religious point of view as a deposit with the central bank. The nature of the rate of the legal reserve and its mechanics do not agree with the terms and conditions regulating the deposit contract. Depositing from the Islamic point of view is to empower others to keep one's money and funds, whether by licensing or by purport, such as when the depositor would say to third parties: I entrust you with the deposit with the other accepting that[2]. The deposit is when the depositor empowers third party to keep his funds and money willingly on the understanding that the former would retrieve it whenever he wants. The deposit, by agreement of the canonists or jurists, is considered a trust in the hands of the depository. It is, accordingly, not guaranteed unless he infringes or defaults. Ibn Rushd stated that they -

---

1 El Bahuti, Ibn Yunes Idris, *Kashaf El Kena'a Ala Matn Al Ekna'a*, Cairo (Egypt): The Mohammedan Sunnah Press, vol.3, 1947, p.312.

2 Ibn Abdine, Mohamed Amin, Hashiyat Ibn Abdeen, Mostafa El Babi El Halabi company and press, vol.3, 2nd. ed., Cairo (Egypt), 1386 H., p.662.

meaning the jurists or canonists - have agreed upon the fact that the deposit is an unguaranteed trust[1]. This does not agree with the fact of the rate of the legal reserve, since the central bank is a guarantor of the amount involved of which it shall not be acquitted except by paying it. Furthermore, the commercial bank cannot retrieve what it had deposited with the central bank whenever it wishes to do so, since the monetary authorities impose it upon the commercial bank to retain part of the cash balances. As long as it has deposits from customers, it will have to retain a part with the central bank. Therefore, it will not be able to retrieve this part deposited with the central bank whenever it wishes as long as it has customer's deposits. From the above-mentioned it becomes clear that the rate of the cash reserve cannot be considered a deposit from the Islamic viewpoint.

(c)- The statement that the rate of the cash reserve is by way of a pledge radically differs with the Islamic concept. Pledge (Rahin) or mortgage from the Islamic perspective is the money that is tied up with the debt which is repaid out of its price if it becomes impossible to have it repaid from the debtor[2]. From this definition, we find that the purpose of pledge lies in the existence of a right for the pledgee with the pledger. The right of the pledgee in relation to the pledge is to hold it until the pledger would pay what he owes. If the pledger fails to repay his debt to the pledgee, the latter would have the right to get his repayment through the object pledged. Therefore, the rate of the cash reserve cannot be considered as a pledge with the central bank since there is no specific right or debt for the central bank on the commercial bank to pledge.

---

1 Ibn Rushd, Ibn El Waleed Mohamed, Bedayat Al Mojtahed Wa Nehayat Al Moktased, El Ma'arefah Printing and Publishing House, vol.2, Beirut (Lebanon), 1401 H., p.310.

2 Ibn Kodamah, Abou mohammed Abdullah, *El-Moghni*, Arabic Book House for Publishing and Distributing, Vol.4, Beirut (Lebanon), 1392 H. P.45.

In this researcher's opinion if legal reserve rate is considered an interest-free loan from the commercial bank to the central bank, it agrees with the Islamic Shariah, with the terms and conditions regulating the loan.

The basic aim of the cash reserve policy is to control the volume of credit within safe and desirable limits and to protect the depositors' rights. The application of this policy does not result in any interest or returns. Therefore, we deem that there does not exist in the Islamic Shariah anything which would contradict the application of the cash reserve rate under the Islamic banking system. That is why we believe that countries like Sudan and Pakistan which have Islamised their economic systems have retained the legal reserve rate, and have obligated all the banks operating there to abide by it[1].

Several researchers on Islamic economy have even gone to the extent of supporting the application of the cash reserve rate in Islamic economy because it is free of direct usurious transaction.

The Islamic Thought Council in Pakistan kept it operative when transforming the Pakistani economy into an Islamic one which is usury-free, after applying a slight amendment to this rate which is related to inflicting a penalty for violating this request by one of the operating banks[2].

Mohammed Najatullah Siddiqi agrees with this viewpoint. He has even commended this opinion and believes that it would be possible to exempt small banks or branches operating in

---

1 Report of the Islamic Thought Council in Pakistan, *the cancellation of interest in the economy of Pakistan*, Translated by Abdel Aleem El Sayed Mansi, Jeddah (Saudi Arabia): published by the International Centre for the Research on Islamic Economy, King Abdul Aziz University, 1984, P.80.

2 Ibid, p.80.

areas where there are no central bank branches from the application of this rate[1].

Omar Chapara believes that the application of this rate should only be confined to current accounts and at call ones without applying it to the investment accounts[2]. Some other researchers believe that the application of this rate under the Islamic banking system should take place, while applying it to the investment accounts at a level that is much less than the rate applied to the current accounts[3]. Others feel that it would be better, under an Islamic economic system, to retain a full reserve amounting to 100% of the deposits to avoid the negative effects resulting from the banks' creation of credit[4].

These opinions can be divided into four main trends in relation to the reserve rate:

a- The application of the cash reserve rate to Islamic banks the way it is applied to conventional or traditional banks.

b- The application of the cash reserve rate to the current accounts as applied in the conventional banks while applying a lesser rate to the investment accounts.

c- The application of the rate to current accounts only.

---

1 Siddiqi, Mohammed Najatullah, *Financial Management in Islam, the Interest-Free Banking System*. Amman (Jordan): The Royal Council of the Islamic Civilization Researches, Al Albayt Organization, 1979, p.72.

2 Chapara, Mohamed Omar, *The Monetary and Banking System under an Islamic Economy,* Dubai (UAE): Translated article published in the Islamic Economy Magazine, Vol.43, January 1985, p.44.and,
Ziauddin Ahmed, & other, *Money and Banking in Islam*, Islamabad (Pakistan): Institute of Policy Studies, 1983, p.40.

3 Fouad, Ahmad Amin, *Islamic Banks and Their Control*, Cairo (Egypt): Islamic Banks Magazine, Issued by International Union for Islamic Banks, vol.41, 1983, p.10.

4 El Jarhi, Mo'obad, *Towards an Islamic Monetary and Banking system*, op. cit., p.53. and,
Kohf, Monther, *Islamic Economy*, Kuwait: Al Qalam House, 1979 p.155.

d- Retaining a full reserve at the rate of 100% of the deposits.

To compare between these four opinions, two things should be taken into consideration:

A) To guarantee the achievement of the objectives resulting from the application of the cash reserve rate.

B) To take the characteristics of the Islamic banks into consideration.

As for the first opinion, calling for the application of the reserve rate as done in conventional banks, we see that by means of this the cash reserve rate shall be applied to the current accounts as well as to the investment deposits in Islamic banks exactly as done in conventional banks. This, no doubt, achieves the objectives of applying the cash reserve rate as aimed at by the central bank. However, this does not suit the nature and characteristics of Islamic banks. It will negatively affect the results of the Islamic banks as most deposits with the Islamic banks are investment deposits which the Islamic bank invests and manages on behalf of the titulars, according to the rules of mutual speculation.

Islamic bank is neither a debtor nor a guarantor except within the limits of sound management and wise disposal. There is no obligation from the Islamic bank to have them totally refunded to their owners who are considered partners with the Islamic bank in profit and loss, within the limits of the deposits. They deposit those amounts for investment by the Islamic bank bearing the consequences of profit or loss and accepting the respective risk factor. Therefore, the application of the reserve rate on their deposits in full implies not investing these funds in full. This would lead in turn to a tie-up of the investment of part of these funds against their will and wish, and would result in depositors earning less return. Thus the retention of a rate of those deposits as a cash reserve will shrink the financing power of Islamic banks and will decrease their investment potentials, leading to a drop in their profitability. Moreover, the rate of the current accounts in Islamic banks to the total deposits is considered a very small one. This is contrary to the state of things in the conventional banks where the increase of the relative weight of current deposits in conventional banks gives the bank more flexibility in using them to alleviate the effects of the reserve rate. Therefore, adopting this opinion would achieve the objectives of the central bank, which it aspires and seeks out of the application of the cash reserve rate. However, this does not agree with the special and distinctive nature of Islamic banks[1].

The second opinion which adopts the application of the cash reserve rate on the current accounts as applied to the conventional banks while applying a lesser rate to the investment accounts, realises the aims of the central bank due to the application of the cash reserve rate, while also agreeing with the special and distinctive nature of Islamic banks. According to this point of view, the current accounts (the deposits at call) in Islamic banks will be subjected to the same rate which the monetary authorities apply to the conventional banks. The investment deposit accounts in Islamic banks shall be subjected to a lesser rate than that which is imposed on the rest of the accounts in conventional banks, taking into consideration the nature of the investment deposits in Islamic banks and to cope up with the distinctive characteristics of these banks. The supporters of this opinion believe that this rate should be much less than that of the conventional banks. So that it would not negatively affect the Islamic banks' results and work, especially that the monetary expansion resulting from placing these deposits is less than the volume of the monetary expansion resulting from the placement of term

1 Afar, Mohamed Abdel Moneim, *The Economic Policies in Islam*, op. cit., p.136.

deposits in relation to conventional banks. This opinion absorbs the characteristics of investment accounts and their distinction from the current accounts in Islamic banks. Therefore, it agrees with the special and distinctive nature of these banks. It simultaneously achieves the aims of the central bank out of its application of the cash reserve rate[1]. Most Islamic economists tend to adopt this point of view as regards the application of the cash reserve rate to Islamic banks.

The third opinion deems that the rate should only be applied to current accounts while exempting the investment deposits from the application of any cash reserve rate. Although it takes into account the distinctive nature of the Islamic banks, yet it does not lead to the achievement of the targets aimed at by the central bank when applying this rate. In case this opinion is applied, the central bank will fall short of achieving the maximum benefit from the application of the cash reserve rate.[2] Thus, it would not be suitable for application in practical life.

The fourth opinion deems the application of the full reserve rate at 100% on the total deposits. It will mean the termination of the efficacy of the credit multiplier since the value of the deposits will be kept in full with the central bank or the commercial bank or in both of them. The few supporters of this opinion believe that this will protect the economy from the negative effects of creating credit, which shall be felt in the increase of the prices levels, the drop in the value of money, and the occurrence

---

1 Hidzir, Yahya, *The Monetary Consideration in the Implementation of Islamic Banking in Conventional Environment*, a research presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996, p.10.

2 El Jarhi, Mo'obad, *Towards an Islamic Monetary and Banking system*, op. cit., p.56.

of inflation[1]. The researcher feels that it is impossible to apply this opinion in practical life.

Therefore, we find that the partial reserve system is the one operative in all the banking systems. Not all the effects of creating credit are negative. There are positive and important aspects of the credit creation processes to the economic activity in society as we have previously shown. That is why we believe that this opinion should not be adopted under the Islamic banking system. In light of the foregoing, the researcher suggests the following in relation to the cash reserve rate:

a- The application of the rate in full on the current deposits with the Islamic banks as applied in conventional ones.

b- The application of a reduced rate on the investment deposit accounts while increasing the reduction scale whenever there is a drop in the liquidity of the investment deposit.

c- That the application of the legal reserve rate under the Islamic banking system will lead to the objectives of the Islamic central bank in relation to the quantitative control over credit at a level similar to that of the conventional banking system.

5.1.2 THE LIQUIDITY RATIO:

The liquidity ratio is considered one of the criteria used to regulate credit and to control it, same as with the cash reserve ratio. This instrument was very similar to the cash reserve rate in terms of the objectives and operating nature. But after some banks faced problems in actual liquidity, it was felt necessary to seek and use criteria which would reflect the real liquidity position in banks in implementation of the principle of cautious control. Banks

---

1 Chapara, Mohamed Omar, *the Monetary and Banking System under an Islamic Economy*, op. cit., p.46.

control required application and supervision. International conferences called for the control and inspection entities to pay special attention to the actual liquidity position in those banks which are subjected to their control and supervision. That is why the basic aim of imposing the liquidity ratio was to control the banks' potential to create credit and to keep it within the safe and desired level. It also aimed at securing the banks' potential to honour their obligations by assuring a certain amount of liquid and quasi-liquid assets available as part of the bank's assets[1].

The mechanics of the liquidity ratio in the quantitative control on credit are the same as those of the legal reserve ratio. If the central bank would wish to enlarge credit base, it would reduce the imposed liquidity ratio. In such a case, the banks would find unnecessary cash surpluses. Thus, they would increase the degree of financing third parties to get rid of these cash balances and to realise profits on them. With expansion in the money supply, the banks' deposits would increase again and the money generating operations would start again. But if the central bank wishes to shrink credit, it would resort to increasing this rate. This would lead to freezing part of the banks' funds and banks would again endeavour to obtain and acquire fresh money. That is why they would resort to those entities which previously granted them financing to retrieve part of what they had provided them with, as a result of which their freedom and potential to grant credit would be restricted and tied up[2].

Therefore, we find that the liquidity ratio in the conventional banking system is an important and principal

---

1 *Report on International Development in Banking Supervision*, Report no.5., Basle (Switzerland): Prepared and Distributed by the Committee of Banking Regulations and Supervisory Practice, September 1986, pp. 38-49.

2 Kabbara, Abdul Rahman Haitham, *Islamic Banks, Monetary policy and reserve*, op. cit., p.44.

instrument in the hand of the central bank. It uses this instrument to control credit and to guarantee the banks' honouring of their liabilities vis-a-vis their customers.

As for the Islamic banking system, it could be possible to adopt the liquidity ratio. Putting it into practice would not result in any usurious transactions or dealings. It has benefit and interest for the nation by controlling the quantities of money supply and keeping them within the desired limits. It also provides security required by customers transacting with the Islamic banks by feeling assured that there is a certain amount of liquidity continuously available as part of the assets of these banks.

Some economists believe this rate would place the Islamic banks in an unfair and uncompetitive position as the liquid assets with the Islamic bank are confined to cash. Cash balances with the central bank and the other banks and with correspondents do not mostly generate a return.[1] As for the conventional banks, we find that most liquid assets with them yield a return, with the exception of cash and balances with the central bank. This confirms the claim that there must exist distinction between the Islamic banks and the conventional ones when laying down the liquidity ratio.

Accordingly, the application of the liquidity ratio under the Islamic banking system requires slight amendments in relation to some of the items of this ratio. It also requires reconsideration of their sub-components which cannot exist in the Islamic banks, and which these banks can deal in such as the treasury notes, the government bonds, their coupons, and the commercial and governmental papers.

Therefore, when the Pakistani government Islamised its economic systems, it adopted this ratio and ordered the member banks to necessarily keep a certain percentage rate of their total liabilities at call, or on term, in the form

1 El Hendi, Adnan, *Central Banks and Islamic Banks*, op. cit., p.12.

of cash, inclusive of the balances deposited with the central bank. This rate was then 35% of the call and term liabilities for each bank in Pakistan. But an amendment was made by not calculating any interest on the bonds kept in the banks' portfolios. After the cancellation of interests from the Pakistani economic system, all banks operating there were requested to replace the governmental bonds and the other bonds with Islamic financial instruments and Islamic investment means as authorised by the Islamic Shariah and as agreed upon by the Pakistani government[1]. In addition to this amendment, another change was made by not calculating a penalty interest on the banks violating this request and replacing that by imposing financial contraventions and penalties to be determined according to a fixed system, following the same method proposed in relation to requesting a minimum limit of the cash reserve.

On the basis of the foregoing, the researcher believes that it would be possible to adopt the liquidity ratio as part of the Islamic banking system at a rate similar to the one applied in the conventional banks. But slight amendments should be made to the constituents of this ratio which conflict with the provisions of the Islamic Shariah, which were approved by the Islamic Thought Council in Pakistan. This is in addition to considering the liquidity deposited with central banks, or part thereof, as amounts allocated for investment in favour of the depositing banks. The central bank would use this liquidity in its religiously lawful speculations in favour of the banks which have deposited them as long as the Islamic banks cannot encash any interest. This has been implemented in Egypt. The central bank there has agreed with the Islamic banks that the latter would deposit funds with it in the form of speculations, and which would appear in the balance sheets

1 *Cancellation of interest in the economy of Pakistan*, Report of the Islamic Thought Council in Pakistan, op. cit, p.106.

of the said banks as quasi-liquid assets[1]. This opinion would be applicable in other countries with their various economic systems, whenever they would wish to Islamise their economy.

5.1.3 DETERMINATION OF THE INTEREST AND DISCOUNT RATES

Central banks may resort to changing the rates of interest, discount and rediscount, to control credit and keeping it within the safe and desired limits. There is no doubt that this method is considered one of the most famous and most ancient ones used by the central banks under the conventional system to control credit by way of affecting the deposit as flows:

(1) CHANGING THE INTEREST RATES

Changes in the interest rate can be done either through changing the depositing interests or the lending interest. The depositing interests are the interest rates encashed by those who transact with banks against depositing their funds with those banks. Central banks resort to increasing or decreasing the depositing interest to affect the flow of deposits injected by those transacting with the banks. This is done either to lure them into depositing their funds by increasing the depositing interest rate or to force them to abstain from depositing their funds by reducing the depositing interest rate. The lending interests are the interest rates which are charged by banks against providing loans to customers. Central banks resort to increasing or decreasing the lending interests to limit the borrowers' demand for credit or to encourage them. If the central bank raises the lending interest rate, those who transact with banks will refrain from borrowing due to the high borrowing

---

1 Al Gharib, Mahmoud Nasser, *Banking Control on Islamic Banks*, a D.Phil. Thesis presented at the Faculty of Commerce, Cairo (Egypt): Ein Shams University, 1991, pp.221-223.
Hidzir, Yahya, *The Monetary Policy Consideration in the Implementation of Islamic Banking in Conventional Environment*, op. cit., pp. 10-11.

costs. But if it reduces the borrowing interest rate, people would seek loans[1].

(2) CHANGING THE DISCOUNT RATE:

The discount rate is the interest rate charged by commercial banks against their discounting commercial papers presented to them by their customers. The rediscount rates are those interest rates which are charged by the central bank from commercial banks against rediscounting the commercial papers or against whatever secured loans and advances it grants them against these papers[2]. Central banks resort to increasing or decreasing the discount rate to limit the demand of transactions with the commercial banks. If the central bank would decrease the discount rate, customers would transact more with the commercial banks to have their commercial papers discounted with them. The opposite would take place when the central bank would raise the discount rat.[3] The central bank also resorts to increasing or decreasing the rediscount rates to influence the resolutions of the commercial banks to grant loans to their customers or to undertake discount operations for them. The increase of the rates means not encouraging banks to lend their customers or accept the commercial papers for discount. But the reduction of the rate means the encouragement of commercial banks to undertake and effect the discount operations of their commercial papers or borrowing from it under security of these papers.[4] Therefore, in the discount operations, the applicant for the discount is the customer, who is either in the form of organisations or in individual

---

1 Koreissa, Sobhi Tadros, & El-Aqquad, Medhat Mohamed, *Money Banks; Economic and International Relationships*, Beirut (Lebanon): El-Nahda El-Arabiyya House, 1983, p.162.

2 Ibid, p. 159.

3 Shafei, Mohamed Zaki, *Money and Banking*, op. cit., P.302.

4 Seigal, Barry N., Siegel Barry, N., *Money, Banking and Economy, A Monetarist View*, op. cit., p.255.

capacities, with the commercial bank being the discounting party. But in the rediscount operations, the commercial bank becomes the applicant for rediscount with the central bank being the discounting party.

(3) CHANGING IN BANK RATE:

The bank rate is the interest rate paid by the commercial bank to the central bank when effecting cash borrowings from it under security of stock or commercial papers.

The central bank uses the bank rate method to control and manipulate credit. If the directives of the central bank would dictate the increase of the volume of credit, then by using the bank rate policy it can reduce the bank rate. If bank rate drops, commercial banks would flock to central banks for loans with a consequential expansion of the volume of credit provided by these banks. When the central bank wishes to reduce the volume of credit, it increases the bank rates thus reducing the loan demand by commercial banks. As a result the volume or size of credit retracts[1].

It is of interest here to get acquainted with the use of such instruments under an Islamic banking system. From the review of these instruments, we realise that the use of these instruments is prohibited in Islamic banks as they represent banned usury. Yet, not using them under the Islamic banking system without creating their substitutes will put the Islamic banks in an embarrassing position and create difficulties. These banks have completely missed out the role of the central bank as the banks' last resort as they are prohibited from borrowing on interest or from having their commercial papers discounted. Furthermore, canceling these tools under the Islamic banking system without creating substitutes will deny the central bank into using one of the most important instruments it uses in

---

1 Koreissa, Sobhi Tadros, & El-Aqquad, Medhat Mohamed, *Money Banks; Economic and International Relationships*, op. cit., p.159.

credit control. That is why it is a must to look for substitute instruments which would achieve the objectives of the central bank and solve the problem of the function of the last resort bank for Islamic banks. Pakistani scholars have proposed the method of profit-sharing to be the substitute to the interests and discount rates. By means of this method, the central bank would extend its financial assistance to banks and the other financial institutions against its partnership in profit fixed at a specific rate, which may change according to necessity.[1] By the same method, the other banks and financial institutions can provide financing to their customers who will assume the position of partners.[2]

The central bank shall have the right to determine the maximum and minimum limits of the rates of profit-sharing. These rates can be changed at any time if the situation dictates and on the understanding that the partnership in the profit and loss would correspond to the relative share in the provided financial assistance. That is why the following was included in the report of the Islamic Thought Council in Pakistan: '.... and the bank rate shall be substituted by empowering the state bank the authority to determine the rates of the profit-sharing in relation to the financial assistance it provides to the banks, ... in addition to determining the maximum and minimum limits of the rates of sharing in the profits of the financing granted by the banks. The rates can be changed at any time, if needs be .....'[3].

---

1 Report of the Islamic Thought Council in Pakistan, *the cancellation of interest in the economy of Pakistan*, op. cit, p.84.

2 Khan, M. Fahim & other, *Fiscal Policy and Resource Allocation in Islam*, Islamabad (Pakistan): Institute of Policy Studies, 1983, pp.221-228.

3 Report of the Islamic Thought Council in Pakistan, *the cancellation of interest in the economy of Pakistan* op. cit, p.84.

Thus, we see that the Islamic Thought Council in Pakistan has relied on the method of partnership rates and the change therein with the aim of influencing the financing relationship between the central bank and the Islamic member banks on the one side and between the Islamic banks and the financing applicants on the other. This method was considered a satisfactory solution to problem of the last resort function undertaken by the central bank.

Mohammed Najatullah Siddiqi agrees and supports this opinion. He suggests that the central banks would satiate the need of Islamic banks as far as liquidity is concerned by providing the required quantity either as a soft free-interest-loan or as investment deposits for a determined period. The following was included in his proposal: '......and what we suggest is that the central banks, which at present supervise the Islamic banks, would respond and provide the request for liquidity from part of these banks by supplying the required quantity of money either as a soft interest-free loan or as investment deposits for a fixed period after ascertaining their needs for liquidity and that public interest dictates responding to that need and requirement'.[1] Siddiqi has also suggested that the central bank can determine the lowest and highest profit margins on the purchase and installments transactions that occur in Islamic banks as a substitute to the interest rate method.[2]

---

1 Siddiqi, Mohammed Najatullah, *The Role of the Central Bank in Relation to the Islamic Bank*. A research presented to the sub-economic committee of the Supreme Consultancy Committee, working on the completion of the application and implementation of the provisions of Islamic legislation in Kuwait: February 1993, p.13.

2 Siddiqui, Mohammed Najatullah, *Financial Management in Islam; The Central Banks in the Framework of Islamic Work*, Amman (Jordan): The Royal Assembly for the Islamic Civilization Researches, All El Bayt Organisation, Vol.1, 1989, p.60.

Other Muslim scholars supported using the method of profit sharing as a substitute to the interest and discount rate policy.[1]

The Iranian central bank has relied on the profit-sharing method as a substitute to the interest and discount rates. It mentioned in article 20 of the usury-free Banking Law in Iran that the central bank is authorised to interfere and control the financial and banking activities according to the following discretions:[2]

a- Determining the highest and lowest limit of the profits rates recovered and collected by the banks in the partnership and speculation activities. These rates shall change according to each one of the financing fields of activity.

b- Determining the different fields of financing and of partnership inclusive of the accepted fields of economic policies, and determining the minimum limit of the anticipated profits on various financing and partnership projects. This minimum limit of the anticipated profits may change according to the economic fields, and the aspects thereof.

Mo'obad El Jarhi proposed new financial instruments which could contribute to the banks' credit potentials. He entitled them as "the central bank certificates". They are of two types: the central deposit certificates, and the central lending certificates[3].

The central deposit certificates grant their titular a share in the deposits of the central bank invested through the

---

1 Afar, Mohamed Abdel Moneim, The *Financial and Monetary Policies and the Possibility of Adopting Them under an Islamic Economy*, op. cit., P.71.

2 Central Bank of Iran, Law for Usury Free Banking, Article 20, Tehran (Iran), 1983.

3 Mo'obad El Jarhi, *Towards an Islamic Monetary and Banking System*, op. cit., pp.78-80.

member-banks. The central bank allocates the proceeds of the central deposit certificates among the member-banks according to the degree of profitability, liquidity and security. This means that the member-banks would be getting the central deposits in relation and proportionate to their sound performance of their investment duties. Banks may lose some or all deposits if there is a drop in their investment efficiency, noting that the central bank issues its investment deposit certificates in different categories and terms.

The central lending certificates stand for assembled funds proceeds attracted from charitable depositors who wish to lend third parties by issuing certificates which represent fixed money rights. The proceeds are used to lend to those who are capable of future repayment. However, they do not entitle a return to their bearers as the motive behind them will be charity.

El-Jarhi believes that the proceeds of these two kinds of certificates could be an instrument in the possession of the central bank through which it could influence and affect the credit potentials of the banks. It may also enable it to provide the member-banks with the liquidity if required.

Yehya El-Tamimi believes that the interest and discount rates policy can be avoided by means of funding or financing which would agree with the principles of the Islamic Shariah[1]. The Islamic banks would receive the commercial papers or bills of exchange for collection on their maturity dates. Against that, the bank would provide a soft interest-free loan to the paper's owner equal to the value of the said paper and against its security after deducting an amount for the administrative fees and the collection duty. The Islamic bank can present the papers to the Islamic central bank, requesting loans from it for the value and

1 El Tamimi, Yehya Mohamed Hussein, *Towards a Central Islamic Bank*, op. cit., p.173.

against their security. The expiry date of those loans would match the maturity date of these papers or bills upon which time the central bank would retrieve the value of its loans against the return of the papers to the Islamic banks for collection of the value from their obligors.

The objective of the Islamic bank from this process would be to provide the service of collecting the papers or bills for its customers and provide them with the necessary liquidity against the collection of some fees to cover its administrative cost and the collection duty.

The objective of central bank lies in providing the Islamic banks with the necessary liquidity to increase the methods of payment. The central bank can undertake an opposite process to limit the creation of credit on the market and the shrinkage of the methods of payment by refraining from receiving these papers and by not providing funding or financing to the Islamic banks if the monetary policy would require that[1].

With the plurality of these methods which are considered as an acceptable substitute to the interest rates and the discount rates under an Islamic economic system, the researcher deems that the policy of profit-sharing is the closest to reality on practical application. That is why he supports it and considers it an acceptable substitute to the policy of interest and discount rates.

The practically of this policy is confirmed by its application in countries like Pakistan, Iran, Sudan which have Islamised their economic systems without problems. Moreover, it is possible to use the other suggested methods gradually and under the continuous control and follow up of the competent entities at the central bank. The results of practical application of these methods should be assessed

---

1 Ibid, pp. 173-174.

before approving them to serve the objectives of the central bank[1].

Accordingly, we shall have practical suggestions to solve the problems resulting from the absence of the interest and discount rates as an instrument for influencing credit, and also for the performance of the last resort function which Islamic banks have missed.

5.1.4 DETERMINING MAXIMUM QUANTITATIVE LIMITS FOR CREDIT EXPANSION:

The central bank lays down maximum limits for loans that each bank can grant to each customer separately or to a group of customers. Thus it would stand as a credit expansion ceiling. This ceiling may be a percentage of some of the resources of the bank as is the case in Egypt, where the central bank determines and fixes the overall standard for credit expansion by a certain percentage of the deposits and equity right. It could also be a lump-sum amount determined by the central bank for each bank as is the case with the Bank of Sudan, where the share of each bank is determined on the basis of certain bases connected with the resources of the bank, the volume of its deposits and the financing expectations, as well as the bank's compliance extent with the previous directives and circulars issued by the central bank[2]. Through this, the central bank aims at controlling the monetary supply to prevent inflation. It directly controls the overall capacity of each bank in granting credit and consequently controlling in the overall capacity of the banking system. So it would not exceed a

---

1 Naqvi, Syed Nawab Haider, *Interest Rate and International Allocative Efficiency in Islamic Economy*. A research presented at Makkah Seminar on the Monetary and Fiscal Economics in Islam, Makkah (Saudi Arabia): October 1978. Published by the International Center for Research in Islamic Economics, King Adul Aziz University, Jeddah (Saudi Arabia): 1982, p.29.

2 Salamah, Abdine, *Islamic Banks and the Islamisation of the Banking System in Sudan*, Khartoum (Sudan): Published by Sudanese Faisal Islamic Bank, 1984, p.24.

certain targeted level which would cope with the safe limits of the national credit volume. It would also preserve the depositors' funds by distributing the placement risks. The credit ceilings is considered as one of the favourite criteria which the central bank prefers to apply to directly bridle credit due to its immediate and quick effects. It is also easy and smooth to implement and follow up from part of the banking control entity. However, it is one of the disliked criteria as this leads to control over their potentials to grant credit and consequently make profits[1].

Islamic economists, however, differ in relation to the validity expansion of this control criterion as regards its application to Islamic banks under an Islamic economic system. Hence, the Islamic Thought Council in Pakistan supported the application of this criterion in Islamic banks after the Islamisation of the Pakistani economic system as was in practice under the conventional banking system. However, a single amendment was made to substitute the penalty interest rate on violating banks with another penalty system such as the imposition of a penalty which would suit the excessive amount over and above the credit ceiling[2].

After the Islamisation of the Sudanese banking system, the Bank of Sudan has kept the use of the policy of credit ceilings for credit control purposes[3]. Najatullah Siddiqi

---

1 Shaker, Fouad, *the Qualitative and Quantitative Control on Credit*. A research presented at the Seminar on the Role of the Financing Institutions in Egypt Organised by Egyptian Society for Financial management, in association with the National Bank of Egypt, Cairo (Egypt): May 1982, pp.72-75.

2 Report of the Islamic Thought Council in Pakistan, *the cancellation of interest in the economy of Pakistan* op. cit, p.81.

3 Al Ghareeb Mahmoud Nasser, *Banking Control on Islamic Banks*, op. cit., p.125.

says that there is no objection to using this policy for direct control over credit[1].

Ahmed Mohye El Dine has also called for the application of this policy to control the Islamic banks, relying in that on the weak pretexts stated by the opponents to the application of this policy under the Islamic banking system[2]. Numerous Islamic economists are against the application of the criterion of the credit ceilings to the Islamic banks because of the special and distinctive nature of Islamic banks, and the nature of the investment accounts therein, as well as the placement aspects which are totally divorced from dealing in debts[3].

Abdeen Salamah, Babakr and Saleh Kamel feel that it would be unnecessary to continue using this instrument in the control over Islamic banks because of the different features and characteristics of the Islamic banks, especially in relating to the investment accounts which represent the major part of the resources of the Islamic bank, and also due to the distinctive contexts and fields of the fund placement[4].

Bekri Al-Basheer feels that the policy of the credit ceilings hinders the Islamic banks' operations and compels them to liquidate several of their operations to avoid exceeding the stipulated ceiling. It also negatively affects

---

1 Siddiqi, Muhammed Najatullah, *Islamic Approach to Money and Banking & Monetary Policies. A review.* A research presented to the Seminar on the Monetary and Fiscal Economics, Makkah (Saudi Arabia), October 1978, p. 36.

2 Ahmed Mohye El Dine Ahmed, *The Role of the Central Bank in Relation to the Islamic Bank*, op. cit., p.15.

3 Ahmed, Ziauddin & others, *Money and Banking in Islam*, Op.cit., p.41.

4 Salamah, Abdine, Islamic *Banks and the Islamisation of the Banking System in Sudan*, op. cit., pp.24-25. and,
Keli, Ba Bakr Mohye El Dine, *The Relationship of the Central Bank with Islamic Banks*, Money and Economy Magazine, the Sudanese Faisal Islamic Bank, Khartoum (Sudan), February 1986' p. 36. and'
Kamel, Saleh, *The Islamic Banking Activity and the Supervisory Role of Central Banks*, op. cit., p.12.

the shareholders' and investors' profits while limiting the flow of deposits into the Islamic banks in Sudan[1].

On the basis of the foregoing, we believe that the Islamic economists are divided as regards the application of the credit ceilings criterion to Islamic banks. The researcher believes that it would be better to apply this criterion to Islamic banks despite their distinctive nature, and the difference in the methods of funds placement from the conventional banks. The researcher gives support to his opinion with the following:

1- That although most of the accounts of Islamic banks are investment accounts, yet they specifically and permanently create a credit which could cause inflation effects and which may have negative effects on the national economy.

2- That not giving a free hand to responsible officials in the Islamic banks to control and direct credit may be abused by some officials in Islamic banks for personal interests by authorisation and exemption. They may favour a certain party in a way that would conflict with the objectives of the monetary and economic policies of the country.

3- That the practical application of the criterion of credit ceilings in those countries which have Islamised their economic systems has achieved several positive results, which encouraged them into retaining this criterion as to credit control despite opposition from economists.

4- That the application of this criterion does not conflict with the provisions of the Islamic Shariah instruments which would achieve the general welfare and

---

1 El Bashir, Bakri Abdel Rehim, *The Effect of the Monetary and Credit Policies of the Bank of Sudan on Islamic Banks*, Al Majmo'a Al Arabia Magazine, vol. 12, Khartoum (Sudan), 1985, p.31.

interest of the nation while protecting economy from any risks or hazards or relapses.

5.1.5 OPEN MARKET OPERATIONS:

The open market operations mean the sale or purchase by the central bank of stocks in general and governmental bonds in particular with the aim of affecting and influencing the money supply according to economic circumstances[1].

Under the conventional banking system, the open market operations are considered one of the traditional operations adopted by the central banks to influence the cash reserves of commercial banks. The central bank interferes on the monetary market either as supplier or seller of some government stocks such as the treasury notes or governmental bonds with the aim of absorbing their legal monetary value from the monetary market. It also acts as a purchaser with the aim of providing the monetary market with the necessary liquidity for as much as the amount of these papers. Thus the central bank undertakes the sale operations of these bonds when there is an excessive liquidity in the national economy with the aim of absorbing the surplus liquidity. It would undertake purchase operations when the central bank wishes to inject a certain amount of liquidity into the national economy. But the matter differs under an Islamic banking system. The open market operations in the conventional sense of the word shall not exist under the Islamic system as they rely on the concept of the fixed interest which is prohibited by Islam.

Several Islamic economists advised against the open market policy for credit control under the Islamic economic system as most Islamic countries lack in having a developed stock exchange market. Besides, this policy is inefficient in relation to limiting the economic fluctuations, especially

---

1 Abdul Mejeed, Abdul Fattah, *the Money Economics Together with an Islamic Perspective*, Cairo (Egypt): Al Kamaliyah Publishing, 1989, p.273.

in developing countries, and also because this policy relies on the prohibited interest[1].

However, the researcher believes that not using this method, while finding no substitute which would agree with the Islamic Shariah, may narrow the area for the instruments used by the central bank in relation to credit control. It would deprive the central bank of an important policy and instrument. That is why the researcher deems that it would be better to try and find an outlet which would enable the usage of such instrument in an Islamic banking system or find an alternative acceptable from the Islamic point of view. Therefore, the Islamic Thought Council in Pakistan recommended that the central bank would issue its bonds with variable dividends or profit coupons. It can use these bonds in the open market operations in such a way that the bond-bearers would participate or share with the central bank in the profit and loss resulting from its local operations on the basis of using the points system or principle in the distribution of the return, with the central bank being empowered for issuing these bonds[2].

Afar feels that it would be possible to use the non-interest-bearing bonds, which is the sole kind permitted in bonds. But he preconditions that they can not be sold at other than the nominal value, i.e. the value of the bond would not be changed from time to time as they represent a determined loan value and that they would be set up on basis of profit-sharing principle. He also says that it would be possible to circulate the shares of the companies of a legitimate activity by sale and purchase inclusive of the open market operations in such a way as would cope up with

---

1 Afar, Mohamed Abdel Moneim, *the Financial and Monetary Policies and the Possibility of Adopting Them Both under an Islamic Economy*, op. cit., p.73.

2 Report of the Islamic Thought Council in Pakistan, *the cancellation of interest in the economy of Pakistan* op. cit, p.92.

and suit the prevailing economic circumstances. Therefore, he says that the sale or purchase of stocks in itself is not considered prohibited in Islam, provided those circulated stocks would be originally permitted, like the shares of the companies of permissible economic activity exclusive of others, and the non-usurious or interest-free bonds which are authorised and which do not bear a specific interest rate[1].

Therefore, in Iran the method of the national participation certificates was used. It is an Islamic partnership method similar to that of the governmental bonds under the conventional banking system. The Governor of the Iranian Central Bank has stated that Iran is about to issue governmental borrowing certificates for the amount of $750 million to give support to its budget. By means of these certificates, investors will participate in the ownership of projects and earn an annual return of 20% and any additional profits which would be distributed upon the maturity of the certificates[2].

According to the foregoing, the researcher feels that it would be possible to adopt the open market policy under the Islamic economic system, provided that this policy is set up on non-interest legitimate bases. The field of activity of this market would be to sell and purchase governmental bonds which are interest-free, and which are based on the principle of partnership with the central banks as to profits, in addition to the sale and purchase of the shares of those companies whose activity is permissible. Thus, and through these two methods (permissible shares and bonds), the central bank will be in a position under the Islamic economic system to use the open market operations in credit control and in achieving its objectives.

---

1 Afar, Mohamed Abdel Moneim, *The Financial and Monetary Policies*, op. cit., P.80.

2 Al Sharq Al Awsat Newspaper, Article entitled Iran Issues Governmental Certificates for 750 Million Dollars, issue of 21/2/1998, p.9.

5.2 THE QUALITATIVE BANKING CONTROL INSTRUMENTS FROM AN ISLAMIC PRESPECTIVE:

The qualitative credit control aims at controlling the kind of credit provided by banks, and having it directed to the desired activities or to those sectors to which the country wishes to direct credit. The requisites of the national economic interest may dictate the encouragement of a certain sector over others or to direct investment towards a specific activity and limit investment in others. Since the quantitative methods do not differentiate one activity from the other when affecting credit, their use in the control and orientation of credit would not be sufficient. This would require the use of criteria aimed at affecting credit and its kind to differentiate between economic activities and sectors by encouraging some and limiting others. This is what is called the qualitative credit control.

Under the conventional banking system, the central bank uses several criteria to control credit qualitatively. We will try to analyse from an Islamic banking perspective the qualitative criteria being used under the conventional banking system. We will also trying to find Islamic substitutes to those criteria which contradict the provisions of the Islamic Shariah. We shall deal hereunder with these criteria through an analytical and detailed explanatory approach:

5.2.1 DETERMINING PREFERENTIAL INTEREST AND DISCOUNT RATES:

Central banks use two instruments for preferential interest and discount rate methods to encourage providing credit in some fields of activity and discourage it in others. This depends on the priorities determined by the monetary policy in the fields of economic activity. Therefore, there would be a reduction of the interest rates on the credit granted to those activities of prime priority. This would also apply to the discount rates of the commercial papers. They could be changed to encourage investment in certain activities. The central bank may reduce the discount rate on the bills presented by industrial organizations to encourage them to increase production and limit consumption. It may increase the discount rate on the commercial papers presented by sectors that do not represent an important priority in the monetary policy.

It is revealed to us that these instruments are considered prohibited and banned usury. That is why it is not permissible to deal in them under the Islamic banking system. However, we have been able to find an Islamic substitute to these instruments which lies in using the profit-sharing method. By means of this method, banks and financial institutions provide the necessary financing to customers against their participation with them in a fixed percentage of profit. This rate can be changed from one sector to another and from time to time[1].

If the monetary authorities would like to direct investment towards a certain sector or towards a determined activity, they would increase the profit rate of the banks which provide financing to these sectors or activities. Therefore, they would encourage these banks to provide more financing to customers desiring to invest in these sectors. In case the monetary authorities wish to discourage people from investing in some sector, they would dissuade banks from providing financing to these sectors by decreasing their profit rate. The financing operations in question emerge through the principle of Islamic speculation or partnership, with the central bank interfering in the determination of the partnership and profits shares. This method is

---

1 For more details about the effect of the interest rate and Discount rate on the credit, please see Page no. 201 of this research work.

successful in Pakistan after the Islamisation of its economic system[1].

5.2.2 THE ALTERATION OF LEGAL RESERVE TERMS AND CONDITIONS:

When discussing the credit control quantitative criteria, we realised that the legal reserve rate is that rate of the customer's deposits which the commercial banks are bound to keep with the central bank[2]. We also realised that it is possible to apply the method of the legal reserve rate under the Islamic banking system as in practice under the conventional system. Many Muslim scholars have supported this procedure[3].

It is possible to use the legal reserve rate policy in the qualitative control over credit and in directing credit towards the desired sectors. While the policy of the monetary or cash reserve is used as a quantitative control instrument over credit, we find it also being used as qualitative credit control method. Mexico is using this method to encourage agro-financing and the financing of cattle breeding or the production equipment. Sweden is also utilising this method to encourage the housing finance or to export capital commodities by taking into consideration the commercial papers or the respective loans provided as part of the reserve assets.

If monetary authorities wish to direct credit to a certain sector, they encourage the banks to provide facilities to customers operating in this sector. For example, the monetary authorities would agree to include the commercial

---

1 Report of the Islamic Thought Council in Pakistan, *the cancellation of interest in the economy of Pakistan,* op. cit, p.86.

2 For more details about the effect of the Legal reserve rate on the credit, please see page no. 187 from this research work.

3 For more details about the view of Muslim scholars about Legal reserve please see Page no. 198 of this research work.

papers presented by a specific sector to which they wish to direct credit into the cash reserve. This would encourage these banks to discount the papers submitted by this sector and to deposit the commercial papers they had discounted as part of their cash reserve rate. Thus, it is possible to change the terms and conditions of the cash reserve to encourage banks to provide credit to certain sectors or to dissuade them from providing credit to other sectors according to the priorities of the monetary authorities. Under the Islamic economic system, it is possible to use the system of changing the terms and conditions of the cash reserve to direct credit towards the desired sectors and activities under the same method adopted by the conventional banking system because this does not involve prohibited usury[1].

5.2.3 THE CHANGE IN LIQUIDITY RATIO:

Through the application of the liquidity ratio, central banks control the banks' ability to create credit and keep it within safe limits, and direct it towards the desired activities by calculating some of the bank's assets as part of the liquid or quasi-liquid assets. The mechanics of the liquidity ratio in qualitative control on credit resemble to a great extent the mechanics of the legal reserve rate. Thus, if the monetary authorities wish to have credit directed towards a certain sector, they would change the terms and conditions of the liquidity ratio to make it possible to direct credit towards that desired sector. They do it by calculating the commercial papers presented by this sector or the loans granted to it or even some of the assets of the bank into and part of the rate determined out of the liquid or quasi-liquid assets required to be kept or retained. Accordingly, they encourage banks to provide

1 Taiudin, Dato Ahmad, *The Operational and Technical Aspects of the Islamic Bank*, Case Study of Bark Islam Malaysia Berhad. A research presented at the Symposium of the Malaysian, Experience in Islamic banking, Kuwait: March 1996, p.25.

credit facilities to this sector due to the advantages it has.

It would be possible to adopt the liquidity rate under the Islamic banking system as no usurious dealings or transactions take place. Instead it helps public welfare and the national interest[1]. It is possible to consider the liquidity deposited with the central banks or even part of it as being amounts allocated to investment in favour of the depositing banks. The central bank would invest this in approved speculations in favour of the banks which have deposited them as long as the Islamic banks cannot encash interest[2].

5.2.4 THE ORGANISATION OF CREDIT SALE OPERATIONS:

Several countries resorted to the organisation of the credit sale operation to control credit and direct it towards desired economic sectors and activities. Through the preliminary down payment, monthly or annual installments and the repayment period, the monetary authorities can direct credit towards a specific sector while keeping it away from other sectors. For instance, if the monetary authorities wish to direct credit towards an industrial sector, they would set soft and easy terms and conditions to enable people to invest in that sector. They can attract people by lessening the amount of the first down payment required for the purchase of machines and equipment, with the remaining payments being settled at relaxed installments in acceptable durations. Investors would find no obstacles in directing their investments towards that sector[3]. On the contrary, the monetary authorities can discourage investors from investing

---

1 Ibid, p. 25.

2 El Hawari, Sayed, *The Arab Banking Legislations: A Comparative Study*, Cairo (Egypt): A study presented to the Arab Administrative Sciences Organization, 1972, p.61.

3 Shafei, Mohamed Zaki, *Introduction to Money and Banks*, op. cit., P.308.

in unwanted sectors. The installment sale operations are permissible under the Islamic economic system. They are in operation in several Islamic countries which have Islamised their economic systems. That is why we see no objection in using them as an instrument to control and direct credit[1].

5.2.5 THE DETERMINATION OF THE LOANS SECURITIES AND THEIR TERMS:

Guarantees and securities are one of the most important elements of loans. That is why the banking regulations empower the central banks to determine the kinds of assets suitable for use as loans securities. They are also authorised to determine the rates and percentages between the value of the asset offered as guarantee and the value of the loan required. The central banks also determine the storage period which suits each asset used as security or guarantee, together with the loans maturity terms. The said terms and conditions are used in affecting and influencing the sorts of credit granted by banks. The determination of the kinds of securities and guarantees dealt in means that there would be demand well anticipated. Similarly, the increase of the lending value in relation to a certain asset would lead to the increase of demand on borrowing against it being used as a security or guarantee. This would lead to expanding in this sort of credit. The opposite would take place when restricting credit. It is also possible to use other terms and conditions to dissuade or encourage the flow of credit towards a certain sector. Among these terms and conditions are those which are related to the maturity terms, the grace periods, and other provisos[2].

Under the Islamic economic system, it would be possible to use the lending restrictions and checks in question in the Islamic funding or financing operations in different

---

1 Central Bank of Iran, *Law for Usury Free Banking*, Article 11, Tehran (Iran), 1983

2 Yosri, Abdel Rahman, *The Economics of Money*, op. cit., p.107.

contexts. Thus, in the cases of profit-sharing and trading and all the forms of legitimate sales, they can be applied. This instrument can also be used in financing or funding on speculation and partnership bases on the assumption that the objective of the securities or guarantees is to face the possibilities of infringement and default or the violation of terms by transacting party. Security or guarantee should not be intended as a means of repaying the principal of the funding[1].

According to the foregoing, we believe that the determination of securities or guarantees and the stipulation of their lending terms and conditions can be adapted to suit the Islamic banking system as part of the qualitative banking control criteria.

5.2.6 DETERMINATION OF THE CREDIT'S CASH MARGINS:

The central bank determines a cash margin which must be paid as a minimum limit for the implementation of some operations such as the letters of credits and letters of guarantee. By increasing or decreasing these margins, it is possible to influence the volume of credit provided through these banking methods.

If the central bank wishes to restrict credit granted to a certain sector, it would increase the percentage of the margins required to be paid in cash. That would drive away the credit applicants, as that would require bigger amounts to cover the required cash margin, which may not be possibly available at the time. Similarly, the opposite would take place upon the reduction of the percentage of the cash margin[2].

1 El Tamimi, Yehya, *Towards an Islamic Central Bank*, op. cit., p.183.

2 Koreissa, Sobhi Tadros, & El-Aqquad, Medhat Mohamed, *Money, Banks, Economic and International Relationships*, op. cit., p.167.

Under the Islamic banking system, we can create lawful contexts to replace the method of the cash margins connected with usurious financing. Thus, it would be possible to use the partnership rate in cases of financing by partnership. In this case the central bank determines the partnership percentage for the bank and its customer[1].

5.2.7 DIRECT RESTRICTIONS IN CONTROLLING THE CREDIT:

The Arab banking regulations include some direct restrictions, restraints or checks which prohibit granting credit to a certain field of activity or which lay down restrictive funding terms and conditions. These restrictions have a direct effect on the kind of credit provided by banks. Usually, these restrictions or restraints differ from country to country. Among these restrictions which influence credit are the following[2]:

1- Prohibiting dealing in real estate and movables by purchase, by sale or by barter.

2- Prohibiting the acceptance of the shares constituting the bank's capital as a guarantee or security of a loan or dealing in these shares except in special cases.

3- Prohibiting the appropriation of shares of joint stock companies in excess of 25% of the value of the paid up capital in the company.

4- That the shares of a certain company owned by any commercial bank would not exceed its fully paid up capital and its reserves.

5- That the same customer would not be granted credit facilities of any kind which, in total, would exceed 25% of the banks fully paid up capital and its reserves.

---

1 El Tamimi, Yehya, *Towards an Islamic Central Bank*, op. cit., p.185.

2 El Najjar, Ahmed, & others, *100 Questions and 100 Answers on the Islamic Banks*, Cairo (Egypt): International Union for Islamic Banks, 1978 [1st. edition], p.21.

6- Prohibiting the financing of some commodities and activities covered by instructions issued by the central bank.

If we analyse these restrictions from the point of view of religious regulations, we find that among these restrictions there are those which do not agree with the characteristics of Islamic banks.

Therefore under the Islamic banking system, it would be possible to accept some of these restrictions which do not conflict with the provisions of the Islamic Shariah and which would not negatively affect the core of the Islamic banking work. As for those restrictions which affect the Islamic bank's performance and operations and which would paralyse its movement, it is a must to find a suitable outlet such as the Islamic bank owning and funding the real estate and the different commodities. Most Islamic partnership and funding operations are carried out through the appropriation of real estates and movables. That is why several monetary authorities in the Islamic world, which have authorised the setting up of Islamic banks, have exempted the Islamic banks from abiding by this provision and empowered them to finance real estates and movables as an exception due to their special and distinctive nature.

5.3 DIRECT CRITERIA FOR CREDIT CONTROL FROM AN ISLAMIC PERSPECTIVE:

After World War II, there emerged some means and methods which were used by some central banks in direct interference in the determination of the volume of credit and in directing it according the different uses. Monetary authorities would resort to these means to directly affect the credit activity of the banks. They would issue instructions through the central bank to either one or all commercial banks for their commitments to the policies laid down by the central bank in the fields of lending, investment or any other fields of activity.

The direct methods are either attractive methods or intimidating ones. The attractive methods are based on persuasion, temptation and enjoyment of special privileges. The intimidating methods are based on sanction and punishment in cases of contravention or non-compliance with instructions, directions and policies. The following stand out amongst the direct methods used by the central bank in credit control and orientation.

5.3.1 MORAL INFLUENCE AND TEMPTATION:

The central banks use the moral temptation policy to influence the commercial banks to restrict and direct credit as dictated by national interest. Thus, it assumes several forms. This may be in the form of memoranda sent to the commercial banks not to extend lending to certain projects and not to accept certain papers. It may also be in the form of a warning against accepting the rediscount of some commercial papers. It may be in the form of a temptation to futuristic facilities, such as a futuristic increase of the credit ceilings allocated to a certain bank. This method was adopted and applied in the United States to encourage banks into expanding on credit for military industries during World War II, and to decrease credit to industries of lesser importance[1].

The researcher sees no objection in using this method in the Islamic banking system as it is. There is no conflict in contents with the requirements of the Islamic Shariah. The teachings of the tolerant religion of Islam even recommend that the Muslim rulers should be obeyed to achieve public welfare. The implementation of the instructions and directions of the central banks by all Muslims (individuals

---

1 Shafei, Mohamed Zaki, *Introduction to Money and Banks*, op. cit., P.314.

and institutions) is a form of obedience to the directives of the ruler who appointed and authorised the central bank to draft and implement the monetary policies. The implementation of this policy in Islamic countries could have a positive effect. It would have positive response from officials in charge of the Islamic banks due to their loyalty to the ruler and the entities he empowers to assist him.

Moral persuasion may be in the form of unofficial contacts, consultations and meetings between the officials of the central bank and those of the Islamic banks. The aim of these meetings is to coax banks or the banking system into following the directives of the central bank policy without the need for issuing official instructions in relation to that or for the use of legal control tools[1].

5.3.2 PERSUASION:

Through credit domination and control, the central bank uses the additional direct means of persuasion by way of direct contact between its officials and those of the commercial banks and financial institutions to work on the expansion of credit in a certain field of activity or restriction in other fields. It also persuades for the credit orientation towards a certain sector or activity according to the requisites of public welfare and the country's economic policy priorities. The success of this policy depends on the extent to which the commercial banks and the financial institutions respond[2].

This policy can be used under the Islamic banking system, as its use realises and achieves the nation's interests and benefits without conflicting with the Islamic Shariah.

---

1 El Jarhi, Mo'obad, *Towards an Islamic Monetary and Banking system*, op. cit., p.64.

2 Siegel Barry, N., *Money, Banking and Economy, A Monetarist View*, op. cit. p. 274.

5.3.3 OBLIGATION:

In addition to its discretionary power to impose general and qualitative credit control measures, the central bank has the authority to issue mandatory instructions to banks in general or to a certain bank in particular on any matter when these banks do not respond to moral persuasion[1].

Undoubtedly, this policy can be adopted under the Islamic banking system, because when the central bank issues such mandatory instructions it issues them as agent to the government to achieve public welfare. As long as those orders and instructions do not project banking operations beyond the framework of religiously lawful provisions, there is no objection to consider them as being one of the means and methods of credit control under the Islamic banking system.

5.3.4 UNDERTAKING SPECIAL BANKING OPERATIONS BY CENTRAL BANK:

It might be necessary for the central bank to undertake some special banking operations if the methods it uses in directing and controlling credit fail to influence the banks' activity as desired. For example, this would take place when the central bank would provide certain credit shunned away by ordinary banks. The intervention of the central bank here is an exception dictated by circumstances and necessities, and not a rule. It is preferable that the central bank would not practice these special banking operations except when needed, and within limits. This way the central bank would dedicate its time to its basic duties, and would not lose its high position by undertaking operations supposed to be handled by the banks and institutions affiliated to it[2].

---

1 Koreissa, Sobhi Tadros, & El-Aqquad, Medhat Mohamed, *Money, Banks, Economic and International Relationships*, op. cit., p.168.

2 Ibid, p. 167.

This method of approach is permissible under the Islamic banking system as long as the banking operations undertaken by the central bank are permissible by the Shariah, and as long as they do not result in the prohibited usury

5.4 ISLAMIC LEGITIMATE CONTROL IN THE ISLAMIC CENTRAL BANK:

By the term Islamic legitimate control in the Islamic financial institutions, it is meant that an authority or a department would exist to control the operations undertaken by these institutions and to ascertain their full compliance with the provisions of the Islamic Shariah. The Islamic regulative control undertaken by the central bank aims primarily at ascertaining that all the regulations, policies, resolutions and operations of the central bank comply with the provisions of the Islamic Shariah. It also follows up all Islamic banks under the supervision and control of the central bank[1].

Several Islamic economists have emphasised the necessity of an Islamic legitimate control authority inside the central bank to supervise and control the operations and activities of Islamic banks. Yet we rarely find such authorities in the central banks of several Islamic countries, with the exception of some countries like Sudan and Iran which have Islamised their economic systems in full[2]. As for the mixed economic system, where central banks control all the conventional commercial banks and the Islamic banks under their purview, it is preferable to have the Islamic legitimate Control Authority. This authority will tighten up the Islamic legitimate control over all the operations and activities of the Islamic banks operating under the central

1 Chapra, Mohammed Omer, & Khan, Tariq, *Monetoring and Supervising Islamic Banks*, Jeddah (Saudi Arabia): Islamic Institute for research and Training: Islamic Development Bank, 2000, p. 31.

2 Ismail, Abdul Halim, *Islamic Banking in Malaysia*. A research presented at the 7th Expert level Meeting of Central Banks. Monetary Authorities and Islamic Banks, Kuala Lumpur (Malaysia): July 1992, pp.22-23.

bank. The activity of the Islamic Legitimate Control Authority here shall not extend to the conventional banks due to the difference of the nature and objective of these banks from those of Islamic banks.

In order to be in a position to provide advice, counselling and assistance to these banks, the Islamic Legitimate Control Authority shall consist of a specific number of specialist Muslim scholars in the field of jurisprudence in general and in the jurisprudence of transactions in particular. Economic, banking and legal elements may be added to this authority[1].

The Islamic Legitimate Control Authority in the Islamic central bank must be an independent entity with extensive control. It would have the power to ask for the information and details it needs, and to provide counsel and opinion in relation to all issues undertaken by it. The operational field of activity of this authority must not be confined to the central bank operations and policies only. It must go beyond that to all the Islamic banks subjected to the authorities and control of the central bank by controlling their activities and ascertaining the viability of their transactions and operations and agreeing to the assigning of its Islamic advisors[2]. Hereunder, we shall indicate the methods of constituting this authority and its duties and tasks.

5.4.1 THE CONSTITUTION OF ISLAMIC LEGITIMATE CONTROL AUTHORITY:

The Islamic Legitimate Control Authority at the central bank consists of a number of Muslim scholars and canonists of comparative law and those economists who believe in the idea

---

1 El Ba'li Abdul Hameed, *Investments and Islamic legislative control in Islamic banks and Financial Institutions*, Cyprus: Published by Faisal Islamic Bank, 1991, p.196.

2 Chapra, Mohammed Omer, & Khan, Tariq, *Monitoring and Supervising Islamic Banks*, op. cit., p. 31.

the Islamic financial and economic system to purify the economic life of Muslim nations of sinful prohibitions. The members of the Islamic Legitimate Control Authority must fulfill the following criteria[1]:

1- Full knowledge of the Islamic jurisprudence with in-depth knowledge of the canonical sciences, especially the jurisprudence of transactions.

2- The ability to give counsel and express opinion as complies with the canonical opinion in all frankness without favouritism or compliments.

3- That they would be selected and appointed by the supreme authorities in the country or by the board of directors of central bank. They must not be subjected to the authorities of the officials in charge at the central bank in order to guarantee independence and being influenced by others.

4- Their knowledge and full grasp of the economic and legal sciences in addition to their specialisation in the religious regulations. If they are not in the grasp of the economic and legal sciences, then scientists in economy and law, who have good reputation, integrity and belief in the idea of applying the Islamic financial and economic system, shall be added to the authority.

5.4.2 THE TASKS OF THE ISLAMIC LEGITIMATE CONTROL AUTHORITY AND ITS DUTIES:

It could be said here that the task of the Islamic Legitimate Authority at the central bank may differ according to the economic system. If the prevailing economic system is the Islamic one, then the duties and tasks of the authority shall be comprehensively global, covering all the

---

1 El Ba'li Abdul Hameed, *Investments and Islamic legislative control in Islamic banks and Financial Institutions*, op. cit., p.218.

activities, work and politics of the central bank, in addition to its own legal control over the operations and activities of all the Islamic banks subjected to the authorities of the central bank. However, if a country has the mixed Islamic and conventional system, then the tasks and duties of the Islamic Legitimate Authority shall be confined to the activities, work and policies of the central bank as related to the Islamic banking aspects only, in addition to its control of the activities and operations of the Islamic banks under the authority of the central bank.

The Islamic Legitimate Authority shall not be authorised to interfere in conventional banking set up. The tasks and duties of this authority shall not extend to cover the conventional banks supervised and controlled by the central bank because of the difference of their nature and objectives from the Islamic banks as we have previously mentioned[1].

The task of the Islamic Legitimate Authority and its duties under an Islamic banking system is confined to the following[2]:

1- To participate with the central bank officials to draft the specimens of contracts and agreements and the data assemblage forms, inspection, and banking control, so that these specimens would cope with the provisions of the Islamic Shariah, incorporating the Islamic banking expressions, idioms and phrases.

2- To undertake the review of all the policies and laws related to the central bank to ascertain that they agree with the teachings of the Islamic Shariah.

---

1 El Kafrawi, Oaf Mahmoud, *Money and Banks under the Islamic System*, Alexandria (Egypt): Egyptian Universities House, 1407H. p.262.

2 Ibid, p. 217.

3- To undertake a study of all the subjects, studies and transactions which are referred to it to express its religiously legal opinion.

4- To make sure of the viability and validity of the activities and operations conducted by the central bank, and that they are devoid of any suspicions or prohibitions.

5- The Islamic Legitimate Control Authority shall submit periodically and whenever needed its reports and remarks to the competent entities.

6- The authority shall submit, at the end of each and every fiscal year, a comprehensive annual report revealing the extent to which the central bank has abided by religious regulations in its operations and transactions, while inserting any remarks it might have to this effect.

7- The board of directors of the central bank may call a representative of the authority to attend its meetings or sessions to provide religiously lawful counselling if required.

8- The authority may request to hold a special meeting or session of the board of directors of the central bank to explain its viewpoint in relation to any religiously legal issues or matters.

9- To follow up the work and operations of the member Islamic banks to ascertain that they conform to the religiously legal provisions. It may ask these banks to provide it with the information and details which would assist it in performing its duties.

10- To compel the member Islamic banks to constitute Islamic control authorities or to have specialist counsellors attached to them. The authority at the central bank shall have the power to appoint the members of the Islamic control authorities or the specialist advisors in the member Islamic banks. It shall also have the right to refuse or reject whoever it may deem unfit.

11- The presentation of an annual report to the competent entities in which it shall indicate the extent to which the member banks have complied with the provisions of the Islamic Shariah in operational transactions and deals.

CONCLUSION:

Credit control is considered one of the most important functions of the central bank. Through this, the central bank tries to control the volume of the money supply to suit the circumstances of national economy. It also controls the orientation of economic activity towards the right direction. The central bank, whether part of a conventional economic system or an Islamic economic system, practices its required activity as related to credit control. Islamic banks, like other commercial banks, eventuate credit but at a lesser degree than that of the other commercial banks and in a different way.

The Islamic central bank resorts to using the quantitative banking control criteria. Through these criteria, it can influence the quantity of credit granted or have it stabilised at its present level. The Islamic central bank may resort to using the qualitative banking control criteria when it wishes to control the quality of credit provided by banks to direct credit towards a certain sector or activity. Also, the Islamic central bank plays its role by using the direct control criteria over credit from an Islamic perspective, in additional to the legitimate control.

Accordingly, in this chapter we discussed the quantitative banking control criteria from an Islamic perspective. We stated and explained the Islamic quantitative criteria related to credit control. We also tackled in this chapter the qualitative banking control criteria from an Islamic perspective. Therefore, we presented the Islamic qualitative credit control criteria that can be used in Islamic central banks.

The topic of direct control over credit from an Islamic perspective was also analysed. The subject of legitimate control in the Islamic central bank was also reviewed. At the end we stated the terms and conditions of the constitution of the Islamic Legitimate Control Authority in the Islamic central bank. We also discussed the assignment and duties of such an authority.

CHAPTER 6

PRACTICAL TRENDS OF THE CONTROL SYSTEMS ON ISLAMIC BANKS IN SOME ISLAMIC COUNTRIES

INTRODUCTION:

The banking and financial systems occupies a prominent position in the economies of all countries. The extent of development in the banking and financial systems shows the economic progress of a country. A combination of political, economic and social factors influences the degree of development of banking and financial machinery.

A follower of the status of banking and financial systems in many Islamic countries will notice the signs of development and modernisation commensurate with political, economic, social and religious changes there.

The banking and financial systems in several Islamic countries had traditional beginning and in many instances they were derived from the Western banking. Most of the Islamic countries modified and amended the Western system to suit their political, economic, social and religious requirements. Their prosperity coincided with the spread of Islamic banks. Most Islamic countries had to develop their banking systems, modernise their sections and branches and set new laws and systems commensurate with the Islamic bank activities by which they can monitor their activities, tighten control and make them move within the aspired banking framework.

Central banks all over the world are entrusted with monitoring the banks operating within their jurisdiction. The success and growth of Islamic banks made it necessary for the central banks to tighten their control on them and monitor them in the same way as the traditional banks. Many countries drafted laws and formulated systems for their central banks commensurate with their controlling and supervisory role with respect to Islamic banks. Some countries had totally Islamised their banking machineries.

We will discuss in this chapter the controlling and supervisory role of the central bank with respect to Islamic banks in some Islamic countries. In order to explain this role in detail, we shall review the central banks' role in Sudan, Iran and Pakistan. We will also review the role of the central bank in Saudi Arabia as a representative of the countries where Islamic banks existed without the presence of Islamic control systems, but which were subject to the traditional laws and systems of the central banks.

6.1 THE CONTROLLING SYSTEMS ON ISLAMIC BANKS IN SUDAN:

The Sudanese banking system has totally shifted to Islamic banking. The economic system there is in line with the teachings of the Islamic Shariah and is derived from it. The Sudanese government urged all agencies of the country to abide by the Islamic systems. Therefore, we find that the Sudanese Central Bank had asked all banks within the country to fully abide by the teachings of the Islamic Shariah. Consequently, it prevented all banks from exercising any work contradicting these teachings. Responsible agencies in the Sudanese Central Bank have enacted laws and systems regulating the Islamic banking operations within the country, and leading to tightening Islamic banking control on the Islamic banks operations.

The experiment of the Islamic banking system in Sudan passed through several phases, varying between success and failures till all obstacles were surmounted. Consequently, an Islamic banking system was created in harmony with the teachings of the Islamic Shariah and at the same time realising for the state and for the control agency in the Islamic central bank its aspired targets.

6.1.1 DEVELOPMENT STAGES OF THE BANKING SYSTEMS IN SUDAN:

The banking system in Sudan had gone through several stages that began before independence. The first bank in Sudan in

1903 was a branch of the National Bank of Egypt. Then branches of other foreign banks opened. Foreign banks had the monopoly till 1957 when the Sudanese Agricultural Bank was established as the first national bank in Sudan. Several commercial banks followed suit. If we overlook the history of banks in Sudan and concentrate on the development of economic thought that governs their work, such development can be divided into the following stages[1]:

(1) STAGE OF COMPLETE USURIOUS BANKING SYSTEM:
This stage represents the period that extended since independence in the year 1956 at the beginning of the national commercial banks era until the year 1978 when Faisal Islamic Bank was founded. Dominance in this stage was for the capitalistic economic thought and the rule of the banking system work was based on the bank interest. The operations of all commercial banks in their banking relationships and financial contracts were based on interest rate, which was the motive for saving and the right granted to deposit holders[2].

(2) THE DUAL BANKING SYSTEM STAGE:
This stage represents the period extending from mid-70s to mid-80s specifically the year 1983 when President Jaafar Numairy ordered the implementation of the Islamic Shariah in all aspects of life in Sudan. Capital owners were made to invest funds according to the provisions of the Islamic Shariah. These decrees led to emergence of the idea of founding Islamic banks which began with the establishment of Faisal Islamic Bank and the Tadamun Bank. Soon a group of other banks followed suit. The banking system in Sudan

---

1 Salama, Abdeen Ahmed, *the Islamic banks and the islamisation of the banking system in Sudan*, Khartoum (Sudan): Colored photos laboratories printing, 1984, P. 53.

2 Al Basheer, Bakur Abdul Raheem, *The Effect of Monetary and Credit policy for Bank of Sudan on the Islamic Banks*, Khartoum (Sudan): Published by Faisal Islamic Bank of Sudan, p.19.

followed two systems: the traditional system represented by the traditional commercial banks, and the Islamic system represented by the forerunners of Islamic banks. Thus the traditional tools were the predominant base on which the monetary policy was centred during this period. Direct intervention was the best approach in the utilisation of Islamic banks' resources during that time because the resources of traditional banks represented the biggest percentage of the volume of resources available to the banking system. The central bank at that time had no trends or mechanisms to deal with the Islamic banking system except the percentages of monetary reserves and internal liquidity reserves, the direct intervention policy and credit ceiling distribution policies[1].

(3) ISLAMISATION STAGE OF THE BANKING SYSTEM:

This stage began in the year 1983 after the implementation of the Islamic Shariah in Sudan and following the enactment of the Dealings Law which obliged all economic activity sectors in Sudan to apply the Islamic law in their dealings. By virtue of the Dealings Law, the Bank of Sudan (the Sudanese Central Bank) issued a circular asking the commercial banks to shift to the Islamic formulae and eliminate interest from all its dealings. This stage lasted till 1991. During this stage, commercial banks began the formal transformation to Islamic banking system. Their activity, however, was hampered by a number of obstacles[2].

Bank control and monetary policy came during this stage, depending on direct intervention in banking activities, which centered on the following:

a- Controlling liquidity by governing the percentage of the banks' statutory and monetary reserves;

---

1 Salama, Abdeen Ahmed, *the Islamic banks and the islamization of the banking system in Sudan*, Op cit, P. 60.

2 Ibid, P. 61.

b- Working with the system of Total Credit Ceilings and Sectoral Markets;

c- Guiding the banks to enter in developmental finance with defined percentages from the credit ceiling (25% for public sector banks and 5% for private sector banks);

d- Determining maximum limits for granting the finance that the banks should not exceed except after consulting the central bank;

e- Working by priorities sectors system for granting the finance.

(4) STAGE OF STRENGTHENING THE ISLAMISATION OF BANKING SYSTEM:

This stage began in the year 1991 after the emergence of the National Salvage Revolution and its adoption of the Islamic approach in all aspects of political, economic and social life. During this stage, full revision of laws, regulations and systems was performed ensuring the abidance by the Islamic Law in commercial banks. During this stage, the Law Regulating Banking Work for the year 1991 and the regulations of administrative and financial penalties for banking violations in the year 1992 were enacted. The Higher Islamic Control Authority for the banking system was established in the Sudanese Central Bank in the year 1992 by virtue of a decree of the Minister of Finance and National Economy, which specified the powers of the Islamic Authority as follows [1]:

a) Setting contracts and agreements for all banking dealings;

b) Controlling the operations of the Sudanese Central Bank and financial institutions;

c) Issuing decrees (Fatwa) and revising the laws and regulations;

d) Providing training in the Islamic banking field;

---

1 Hefni, Jamal Anwar Mohamed, *the role of the Sudanese banks in the economic development*, Khartoum (Sudan): a practical study on Sudan, Al-Resala printing & publishing house, 1986, P.46.

e) Preparing researches and studies in the field of Islamic banking.

This stage represents a stage of strengthening the Islamisation of banking system, spreading the Islamic banking culture and training and qualifying the workers in the banking system. The most important aspect of reform during this stage was to ensure the legitimate abidance in banking transactions. All banks operating in Sudan were urged to form Islamic control bodies, following approval of the general assemblies of these banks. These Islamic authorities were to assume the tasks of developing legitimate abidance in banking dealings and for integrating the central bank's control with that of the general assemblies through the Islamic control bodies in those banks.

6.1.2 ISLAMIC FINANCE INSTRUMENTS USED BY THE SUDANESE BANKING SYSTEM:

The Islamic banking forms used in the Sudanese banking system comprise most of the known Islamic finance forms, since the Sudanese banks distribute their resources between various utilisations according to the risks connected with each form and pursuant to the policies prescribed by the Central Bank of Sudan. The forms used in the Sudanese banking system in investment and finance transactions are as follows[1]:

- Restricted and unrestricted speculation (Mudarabah);
- Permanent and decreasing partnership (Musharakah);
- Profit sharing (Murabaha);
- Delayed transactions (Salam);
- Manufacturing (Istsna'a) ;
- Leasing (Ijara'a);

---

1 Mohamed, Assem Al-Haj, *Investment Guarantees of Islamic Banks in Sudan*, Al-Khartoum (Sudan): Publications of the bank of Sudan, 2003, P. 32.

These forms remained the reference for dealing in the Sudanese banking system. The utilisations of Sudanese banks resources were distributed between these forms. The following schedule illustrates the share of each finance form in the total resources of the Sudanese banking system from year 1998 to year 2002 (in billion Sudanese dinars). It also illustrates the share of each finance form as a percentage of the total finance in the Sudanese banks[1].

Table No. 6.1

Size and Distribution of Banking Finance in Sudan according to the Islamic Finance Forms

Amount in Billion Sudanese Dinars

Year / Finance Form	1998		1999		2000		20001		2002	
	Amount	Percentage %	Amount	Percentage %	Amount	Percentage %	Amount	Percentage %	Amount	Percentage %
Murabaha	25.5	54.4	36.2	49.1	34.2	33.86	57.9	39.6	74.2	35.9
Musha rakah	9.9	21	22.7	30.8	43.5	43.1	45.3	30.96	57.7	28
Mudarabah	2.8	6	3	4.1	3.8	3.76	9.1	6.22	9.6	4.6
Salam	3.1	6.6	3.7	5	3.3	3.27	7.3	5	6.9	3.3
Other	5.6	12	8.1	11	16.2	16	26.7	18.25	58.4	28.2
Total Finance	46.9	100%	73.7	100%	101	100%	146.3	100%	206.8	100%

We notice the following from the above schedule:

1- The Banking finance in Murabaha form occupied the largest share of the total flow of Sudanese banking

1 Ahmed, Ahmed Majzoub, *Evaluation of the Sudanese Islamic Banks role in Developing the banking work*, Mekkah (Saudi Arabia): a research presented to Al Baraka Seminar No. 42 concerning the Islamic Economy, October 2003, P. 6.

finance according to the forms. This was in view of the long experience of Sudanese banks in exercising the finance in this form, in addition to the few risks in it, besides guaranteeing the return and profit in finance transactions in Murabaha form, contrary to the other forms

2- Starting the year 2000, the finance transactions in Murabaha form began to drop gradually due to the trend of finance policies of the Central Bank of Sudan which tended to decreasing banking finance through Murabaha and encouraging banking finance through the other forms. Another reason for the drop in Murabaha transactions was the banks' application of the Murabaha form according to determined conditions as mentioned in the Philological Guide of Murabaha Form by which the Sudanese Central Bank obliged all Sudanese banks to abide

3- Increasing of banking finance through the form of partnership (Musharakah) starting from the year 2000 in response to the finance policy directives of the Central Bank of Sudan, which aim at decreasing banking finance through Murabaha form in return for encouraging the use of other finance forms.

6.1.3 BANKS CONTROL IN SUDANESE BANKING SYSTEM:

The Central Bank of Sudan by controlling all banks and financial institutions operating in Sudan aims at ascertaining the capability of these banks and financial institutions to fulfill their obligations towards their customers. It also essentially aims at executing the monetary and financial policy of the country. Therefore, the directives at this stage, as represented in strengthening the Islamisation of the banking system, necessitate that monetary and financial policy of the Central Bank of Sudan shall abide by the Islamic finance forms in their financial contracts, and that these forms shall be the controller of their procedures and tools as well as the influential factor in achieving their targets. The Law regulating banking work for the year 1991 is considered the law regulating all banking operations in Sudan. This law comprises various regulations for suspending the banking activities of any bank or financial institution[1].

Thus, control on the banks operating in Sudan centres around the effect of Islamic finance forms on the monetary and finance policy. Controlling and orienting the monetary policy in the Sudanese banking system mostly takes place by using two methods and two control frameworks, namely[2]:

- Quantitative Framework.
- Qualitative Framework.

We provide here the details of the quantitative and qualitative tools used by the Sudanese Central Bank in controlling Sudanese banks and, consequently, directing the Sudanese credit and economic activity.

(A) QUANTITATIVE TOOLS OF THE MONETARY POLICY IN THE SUDANESE BANKING SYSTEM:

These tools aim at determining the overall volume of liquidity necessary for the economic activity[3]. They affect the amount of money in economy. This means influencing the banks' finance forms, controlling their ability to increase the finance to different fields and sectors. The total volume prescribed for liquidity in the country is determined on the basis of the economic form to be agreed upon between the Ministry of Finance and the Sudanese Central Bank. Through this, the targets of the monetary and economic

---

1 Mustafa, Abdul Raheem, *Banking System and the Monetary Policy in Sudan*, Um Durman (Sudan): Um Durman Islamic University, 1991, p.86.

2 Ahmed, Ahmed Majzoub, *Evaluation of the Sudanese Islamic Banks role in Developing the banking work*, op. cit., P. 18.

3 Ahmed, Ahmed Majzob, *Monetary Policy in Islamic economy*, Makkah (Saudi Arabia): MA thesis submitted to Faculty of legislation and Islamic studies, Um Al Qura University, 1983, p.117.

policy as a whole are realized. Consequently, the following indicators shall be determined[1]:

1- Reaching the required growth rate in the national gross product;
2- Reaching the permissible inflation rate;
3- Achieving a rate of increase commensurate with the amount of the cash in the society and distributing it between the government and the private sector;
4- Achieving the required surplus percentage in the trade balance and the balance of payments, which is considered an indicator of the external balance;
5- Reaching the required amount of foreign currency reserves, which should be maintained by the Sudanese Central Bank.

These indicators are considered the guide of the Sudanese Central Bank in controlling the overall volume of liquidity in the economic activity. Based on that, the most important quantitative tools used by the Sudanese Central Bank in controlling the banks and financial institutions for executing the monetary and finance policy and for controlling the credit shall be the following:

(1) LEGAL RESERVE RATIO:

This is one of the direct monetary policy tools through which the banks keep a percentage of their deposits with the central bank, for example 10% or 15% of the deposits. This percentage shall be approved as part of the total current deposits in local currency, in addition to a percentage of the total deposits in foreign currencies. This percentage shall not be reckoned from the investment deposits. The volume of deposits in each bank shall be revised monthly to ascertain the banks' obligation in maintaining this percentage, and punitive procedures shall be applied against banks which violate the requirements of this tool.

---

1 Mohamed, Assem Al-Haj, *Investment Guarantees of Islamic Banks in Sudan*, op. cit., P. 36.

In realising the aim of legal reserve control, this tool depends on the credit multiplier which determines the capability of banks in generating money. The following schedule comprises the development of this percentage in the Sudanese banking system between 1994 and 2001[1].

Table No. 6.2

The Development in the Legal Reserve Ratio as set forth in the monetary policies in Sudan

Year	Percentage in local currency	Percentage in foreign currency
1994	20%	Nil
1995	30% in the first half of the year and 25% in the second half of the year	Nil
1996	25%	Nil
1997	26%	4%
1998	26%	4%
1999	8%	6%
2000	12%	10%
2001	12%	12%
2002	14%	14%
2003	14%	14%

(2) INTERNAL LIQUIDITY RATIO:

It has been noticed that the liquidity percentage determined by the Sudanese Central Bank began to be applied to the banks operating in Sudan starting from the year 1986. It was within the limits of 10% of the total current deposits, because this percentage was not applied to the years prior to 1986. Applying this tool continued since 1986 and during the following years. This percentage was stable within the limits of 10% of the total current deposits until it was cancelled in 2001.

1 Ahmed, Ahmed Majzoub, *Evaluation of the Sudanese Islamic Banks role in Developing the banking work*, Op. cit., P. 21.

The following table illustrates the development of the internal liquidity ratio that was determined by the Bank of Sudan from 1994 to 2003.[1]

Table No.6.3

Development in Liquidity Ratio as set forth in the monetary policies in Sudan

Year	Percentage of Internal Liquidity
1994	10%
1995	10%
1996	10%
1997	10%
1998	10%
1999	10%
2000	10%
2001	It cancelled and left as an indicator for banks
2002	-------
2003	-------

(3) OPEN MARKET OPERATIONS:

The Sudanese Central Bank was able to create some financial tools in line with the Islamic Shariah and develop them in a way making them valid for use within the framework of the open market policy. These tools rest on legal basis totally clear of usury as they depended on the forms of partnership, speculation, Murabaha and Salam. They were established by virtue of monetisation or securitisation of certain assets owned by the Bank of Sudan or the government, which become securities and certificates negotiable in stock exchanges markets. These securities and certificates are as follows[2]:

1 Ibid, P.21.
2 Ibid, P.22.

A- CENTRAL BANK PARTNERSHIP CERTIFICATE (SHAMAM):

The Sudanese Central Bank issued this certificate in 1998 by establishing a financial fund. Its capital is formed of the share of the Sudanese Central Bank and the Sudanese government in the banking sector. The total capital of this fund was divided into financial certificates enjoying the following characteristics:

1- Having a nominal value recorded in the certificate;
2- Having a book value expressive of the nominal value of the certificate and its actual share in the realised profits and the increase in its capital value;
3- Having an exchange rate to be determined by negotiation between buyer and seller;
4- Having no validity period and can be circulated;
5- Purchase and sale transactions shall be carried out between the Sudanese Central Bank and the commercial banks in auctions;
6- Enjoying a high level of liquidity.

This certificate is based on the partnership form, for the fund to be established shall represent the partnership capital and the certificates represent the share of each partner. The Sudanese Central Bank uses these certificates in managing liquidity and achieving the monetary policy targets by entering as buyer of these certificates when the policy is expansionary and as seller when the monetary policy is deflationary.

B- GOVERNMENT PARTNERSHIP CERTIFICATE (SHEHAMA):

The Sudanese Central Bank issued this certificate in 1999. It depends on collecting some or all the shares of the government in a number of institutions, companies and authorities in an investment fund so that the total of these shares forms the fund's capital. This idea came for realising two aims: first, to finance the governmental expenditure by monetising some fixed assets of the government through this fund, so that these certificates would be sold to public according to the nominal value of each certificate. The buyer of the certificate would become a partner in the government's assets and the government would obtain the value of these certificates for financing its deficit in revenues. The other aim of this certificate would be to create a financial tool enabling the Sudanese Central Bank to manage the liquidity in the Sudanese economy.

This certificate also represents a method for pooling the savings from the citizens, which would be circulated in auctions through Sudan Company for Financial Services, a financial company in the Sudanese Capital Market. This certificate enjoys the following characteristics:

1) Having a validity period of one year;
2) Having high profits formed of the capital profits which represent the change in the assets' value;
3) The certificate would be registered in its holder's name who would become partner with the value of his/her certificate in the fund's shares in the companies and institutions forming it;
4) It would be transferable and have a secondary market as well as a high liquidity.

The working mechanism of this policy would be through the Sudanese Central Bank entering as buyer of these certificates when the monetary policy is expansionary and seller when it is deflationary. This policy would perform its main role as a tool of the financial policy in financing the balance sheet deficit.

C) GOVERNMENT FINANCE BONDS (SARH):

The Sudanese Central Bank began issuing these bonds in 2003. They were based on defining the purchases that the government wants during the fiscal year or the projects it planned to establish, then determining their total value. A fund would then be formed for these projects for issuing bonds with a nominal value to be floated for the public. The bond value would represent a share for the buyer in this fund and the total value of the bonds in the fund would represent the total capital of the fund. The specialised company in the Sudanese Capital Market, the Financial Services Company, would manage this fund and the speculation contract would govern its relationships with bondholders. The fund's management would deal with the government in providing the requirements according to the appropriate contract for fulfilling the government needs. For example, it would be a Murabaha contract in case of equipment and machinery purchases, and the Manufacturing (Istisna'a) in case of executing the different projects, the leasing (Ijarah) contract in some infrastructure projects like the roads and establishments projects, and certain equipment.

The governmental bonds would be circulated in the secondary market. They would accordingly become one of the securities used by the Sudanese Central Bank in its monetary policies.

(4) INVESTMENT OUTLET POLICY:

The working mechanism of this policy is represented in extending finance by the Sudanese Central Bank to banks operating under its supervision. Speculation operation is the working framework of such finance. Banks are required to determine the share of the fund owner, namely the Sudanese Central Bank in this case, in the profit of the finance transaction. In this case, the finance shall be provided from the Sudanese Central Bank to one of the banks operating in the country, through a bidding open to all Islamic banks. The finance is accorded to the Islamic bank offering a higher profit rate to the Sudanese Central Bank.

The Sudanese Central Bank uses this policy according to the requirements of the monetary policy followed by the bank. These requirements are connected with the volume of liquidity which is necessary for economic activity in Sudan so that it suits the degree of monetary expansion determined according to the economic pattern aspired by the country.

The Sudanese Central Bank also employs this policy in bridging the gap in banking finance at any time. The Sudanese Central Bank executes this policy through unrestricted speculation contract, in which case the central bank is owner of the fund while the Islamic bank is owner of the work and the one benefiting from this outlet. According to this policy, competition takes place between the Islamic banks operating in Sudan, because the bank offering to the central bank the highest profit share in the speculation operation benefits from this opportunity[1].

(5) BRIDGING LIQUIDITY DEFICIT GAP POLICY:

This policy aims at helping the Sudanese banks, which face problems in managing their internal liquidity, in a way enabling them to fulfill their short-term obligations. The relationship between the Sudanese Central Bank and the bank benefiting from this policy is governed by the absolute speculation contract. The Sudanese Central Bank deposits the amount of liquidity deficit in the account of the concerned bank as a term investment deposit. This does not usually exceed two weeks. The profit is distributed at the rate of 90% to the Sudanese Central Bank and 10% to the concerned bank. If the bank succeeds in solving the liquidity problem within one week and is able to refund the investment deposit, the Sudanese Central Bank shall relinquish the prescribed profit. But if the concerned bank fails to refund the liquidity within a period of one week, the Sudanese Central Bank shall get its prescribed share in the profits for the two weeks.

(B) THE QUALITATIVE MONETARY POLICY:

The monetary policy according to this framework aims at distributing the volume of banking resources among various economic sectors in the country. The Sudanese Central Bank, based on that framework, attempts to influence the different finance forms used by the Sudanese banks and the

---

1 Ibid, P.24.

relationships governing them for directing the volume of credit, concentrating it in specific economic sectors and diverting it away from other economic sectors. This is done to realise balance between various economic sectors by directing the monetary policy of the country. Thus, the relation between the bank and its customer shall be the core of procedures and tools on which the monetary and finance policy rests. The monetary tools used according to this framework are called Qualitative Tools of the Monetary Policy.

The qualitative tools of the Sudanese Monetary policy used by the Sudanese Central Bank are as follows:

(1) POLICY OF DISTRIBUTING THE FINANCIAL CEILING BETWEEN THE ECONOMIC SECTORS:

This policy is considered one of the direct qualitative monetary policies used by the Sudanese Central Bank. This aims at defining the share of each economic sector from the total finance ceilings available for each bank. According to this policy, the sectors are classified into important and less important sectors. The important sectors comprise the agricultural sector with its vegetal and animal branches, the industrial sector, the sectors of mining, energy production, transport and storage, social development sector, and housing sector. These sectors enjoy a high percentage of finance ceilings which are determined by the Sudanese Central Bank for directing credit to them. There are also auxiliary sectors of lower importance including the local trade and services sector. For these the Sudanese Central Bank determines defined credit ceilings lower than those of the priority sectors[1].

If one sector is important in a certain year, its credit ceiling will rise and if its importance decreases in another year, its credit ceiling will decrease.

---

[1] Mustafa, Abdul Raheem, *Banking System and The Monetary Policy in Sudan*, op. cit., p.93.

Therefore, it is noticed that the Sudanese Central Bank is concerned with the sector of the small ventures within the framework of the state's policy that aims at developing the countryside and at realising a better standard of living for the citizens. The responsible authorities in Sudan began since 1999 appropriating 5% of the total finance ceilings for this activity. Then these ceilings started to increase during the following years until they reached 10% in the year 2001. It maintained the same level until the year 2003. Also, the industrial sector emerged as one of the sectors for which an important ceiling was determined. In the year 1998, 30% of the total finance ceilings available in Sudan were appropriated for this sector. This was in addition to determining a percentage of 25% of the total finance ceilings for the sector of exports to encourage the exporters to expand their exporting activity and capture fresh markets for the Sudanese products[1].

The following table illustrates the distribution of resources available for Sudanese banks, among all sectors. It transpires that the agricultural sector appears to be favored with the highest percentage of credit ceilings. In the past, there was no discrimination within the agricultural sector. But from 1995, the finance ceiling was divided into agricultural and livestock sectors to affirm the tendency of the monetary policy towards paying attention to the animal wealth[2].

---

1 Ahmed, Ahmed Majzoub, *Evaluation of the Sudanese Islamic Banks role in Developing the banking work*, Op cit, P. 27.

2 Ahmed, Ahmed Majzoub, *Evaluation of the Sudanese Islamic Banks role in Developing the banking work*, Op cit, P. 28.

Table No. 6.4

Distribution of Finance Ceilings between the Different Economic Sectors in Sudan

General description	High Priority Sectors					Non-High Priority Sectors
	Agriculture	Industry	Producer Families & Small Producers	Others	Total	
1991/1992	40%	0%	0%	40%	80%	20%
1993	50%	0%	0%	40%	90%	10%
1994	40%	0%	0%	50%	90%	10%
1995	25% Vegetal 15% Animal	0%	0%	50%	90%	10%
1996	25% Vegetal 15% Livestock	0%	0%	50%	90%	10%
1997	30%	3% Industrial 25% exports	0%	10%	95%	5%
1998	25% Vegetal 5% Animal	30% Industrial 25% exports	0%	10%	95%	5%
1999	25% Vegetal 5% Animal	30% Industrial 30% exports	5%	0%	95%	5%
2000	25% Vegetal 5% Animal	30% Industrial 23% exports	7%	0%	90%	10%
2001	25% Vegetal 5% Animal	30% Industrial 20% exports	10%	5%	95%	5%
2002	25% Vegetal 5% Animal	30% Industrial 20% exports	10%	5%	95%	5%
2003	25% Vegetal 5% Animal	30% Industrial 20% exports	10%	5%	95%	5%

(2) THE POLICY OF DETERMINING THE SHARE OF EACH ISLAMIC FINANCE INSTRUMENT FROM THE RESOURCES AVAILABLE TO THE BANK:

The Sudanese Central Bank depended on determining general directives in the monetary policy defining the types of finance forms used by the Islamic bank in investing its resources. The Sudanese Central Bank imposed this policy after noting the overuse of Murabaha form compared to the other available finance methods due to the ease in dealing by this form and the bank's ability to determine the profit in each Murabaha transaction. The share of Murabaha form from the finance processes in the Sudanese banking system was equivalent to 54% in 1998. It began to decline during the following years till it reached 49% in 1999. Then it decreased to 33.7% in 2000, and again increased 39.5% in 2001. It decreased again to 35.9% in the year 2002. The main reason for the gradual decrease in using Murabaha form was the directives of the Sudanese Central Bank to the Sudanese banks to reduce Murabaha form use in finance operations in order to execute the state's monetary policy directives which provided that the finance extended by the banks on the basis of Murabaha form should not exceed 30% of the total extended finance[1].

The monetary policy some times comprised direct directives prohibiting the use of certain finance forms as happened to the absolute speculation form in the monetary policy for the year 2002.

(3) THE POLICY OF DETERMINING THE DOWN PAYMENT IN MURABAHA TRANSACTIONS:

Within the framework of the Sudanese monetary policy aimed at finance forms used in the Sudanese banking system, the Sudanese Central Bank adopted another policy towards

---

1 Abdullah, Ahmed Ali, *Islamic Banks; Available Instruments of Islamic banks in Financial Markets*, Beirut (Lebanon): Union of Arab Banks, 1989, p.136.

Murabaha finance form used by the Sudanese banks. This new policy is connected with the amount the customer should pay in advance in the Murabaha transaction. The monetary policy raises this amount in the sectors it does not wish to expand and lowers it in the sectors and activities it wishes to expand.

The following table illustrates the first installment that the customer should pay for obtaining the commodity by Murabaha transactions according to each of the economic sectors in Sudan[1].

Table No. 6.5

Down Payment amount in Murabaha transactions according to the Economic Sectors in Sudan

General description	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
High Priority Sectors	25%	36%	36%	30%	36%	25%	25%	25%	25%	25%
Second Productive Sector	15%	0%	36%	40%	36%	25%	25%	25%	25%	25%
Second Non-Productive Sector	35%	0%	0%	40%	36%	25%	25%	25%	25%	25%
Craftsmen	15%	25%	20%	35%	36%	25%	25%	25%	25%	25%
Exports	25%	30%	30%	40%	36%	25%	25%	25%	25%	25%
Small Producers	15%	15%	15%	30%	36%	25%	25%	25%	25%	25%
Agriculture	15%	15%	15%	30%	36%	25%	25%	25%	25%	25%
Industry	25%	30%	30%	40%	36%	25%	25%	25%	25%	25%

(4) THE POLICY OF INFLUENCING THE PROFITS GENERATED FROM THE FINANCE INSTRUMENTS:

The Sudanese Central Bank approved the policy of influencing the profits generated from the finance forms used in the

1 Ahmed, Ahmed Majzoub, *Evaluation of the Sudanese Islamic Banks role in Developing the banking work*, Op. cit., P. 30.

Sudanese banks and determining the percentages of their distribution between customer and bank as one of the qualitative policies aiming at restricting or expanding a form of its finance. As an example, we find that the monetary policy in the Sudanese banking system comprises obligatory indicators about the margins of profit in the Murabaha operations by which the Sudanese banks are bound to abide. Therefore, the Sudanese Central Bank usually resorts to raising Murabaha margin in the activities to which it does not wish to direct the banking finance, and lowering it in other sectors it wishes to expand their finance. The following table illustrates Murabaha margins determined according to the Sudanese monetary policy for each sector or activity from the year 1994 to the year 2003[1].

Table No. 6.6

Murabaha Margins According to the Economic Sectors and Activities in Sudan

General description	Exports	Craftsmen	Small producers	Productive Seeds	Non-productive seeds	Agricultural & industrial	Other
1994	30%	25%	15%	25%	36%	36%	36%
1995	30%	25%	15%	36%	36%	30%	36%
1996	30%	20%	15%	36%	36%	30%	36%
1997	40%	35%	30%	40%	40%	40%	40%
1998	36%	36%	36%	36%	36%	36%	36%
1999	20%	20%	20%	20%	20%	20%	20%
2000	18%	18%	18%	18%	18%	18%	18%
2001	12-15%	12-15%	12-15%	12-15%	12-15%	12-19%	12-15%
2002	12-15%	12-15%	12-15%	12-15%	12-15%	12-15%	12-15%
2003	12%	12%	12%	12%	12%	12%	12%

We notice from the previous table the increase in Murabaha margins of profit during the period form the year 1994 to

1 Ibid, P. 32

the year 1998 reflecting the rise in inflation rates that prevailed in Sudan at that time, which necessitates that the realised profits be commensurate with the decrease in the currency purchasing power. Also the decrease in profits of the following years reflects the improvement in the Sudanese economic performance and the stabilisation realised in it until the influential rate of profit in the Murabaha operations in the year 2003 reached the level of 12%.

(5) THE POLICY OF CHANGING THE PARTNERSHIP PERCENTAGE BETWEEN THE CUSTOMER AND THE BANK:

Within the monetary procedures of qualitative effect used by the Sudanese Central Bank are those procedures that are connected with the change of percentage of the bank's partnership with its customers in the finance operations that take place based on the partnership form. When the Sudanese monetary policy is of an expansionary target, the Sudanese Central Bank increases the share of the bank offering the finance in the partnership and, consequently, decreases the partner's share. The opposite occurs when the monetary policy is deflationary where the central bank decreases the share of the bank offering the finance to the least possible level and raises in return the customer's share. Accordingly, distinction can be made between the high priority sectors and activities and the other sectors considered as auxiliary. Thus, the bank's share in the partnership decreases in the high priority sectors and increases in the auxiliary sectors.

As an example, we find that the monetary policy in the Sudanese banking system provided in 1996 that the customer's partnership percentage in the local trade shall not be less than 60% of the total value of goods. By considering it an auxiliary sector in the Sudanese economic system, the monetary policy decreased the customer percentage of partnership with regard to the foreign exports to 25%. The monetary policy aimed at encouraging the foreign exports sector.

6.2 THE CONTROLLING SYSTEMS ON ISLAMIC BANKS IN IRAN:

The Iranian banking system is considered the first in the world that totally shifted to Islamic banking system. It started to adopt Islamic principles after the 1979 revolution. Starting from that date there were numerous activities that has taken place and several decisions that have been made by the Iranian authorities concerning the issue of Islamisation of the banking system in Iran.

We will discuss in the coming parts the development of the Islamic banking in Iran and the role of the Iranian central bank in controlling the Islamic banks in Iran, in addition to the bank facilities that can be granted by Islamic banks in Iran.

6.2.1 THE DEVELOPMENT OF THE ISLAMIC BANKING IN IRAN:

Before the revolution in Iran, and by the year 1978, there were 35 banks operating in Iran. The National Bank of Iran with a paid capital of 16,000 million rial was the most prominent Iranian bank. Bank Saderat with half of the capital had the largest branches inside Iran. Its branches in Iran and abroad totaled 2,902 units. There were many international jointly-owned banks.[1]

After the 1979 revolution, which ousted the Shah's regime, Iran started its process of Islamisation of the banking system. The Iranian authorities took steps to bring the banking system operations in harmony with the requirements of Islamic law. The implementation of Islamic banking system, however, was on a gradual basis and took six years to be fully implemented. Subsequent to the Revolution, there were about 35 banks in Iran and the system relied on both

---

1 Amin, S.H., *Islamic Banking and Finance: The Experience of Iran*, Tehran (Iran): Vahid Publications, 1986, p.40.

the government and the private sectors as well as the domestic and foreign sectors for funds.[1]

On June 8, 1979, the banking system was nationalised by the Revolutionary Council. There was also a reduction in the number of banks through mergers. After mergers only six commercial banks and three specialised banks remained operative. In addition, 22 provincial banks (one for each province) were established.[2] In February 1981, administrative steps were taken by the central bank to eliminate interest from banking operations. At the same time, a bill was prepared by a group of individuals from various backgrounds to bring the operations of the entire banking system in total compliance with the Islamic Shariah. The proposed bill was submitted to the Revolutionary Council in March 1982 and was passed by parliament in August 1983 as the Law for Usury-Free Banking. The law is broadly divided into five topics and was implemented on March 1984. This law required banks to convert their outstanding interest-based deposits to interest free within one year. The banks were also required to convert their operations as outlined by the new law within three years from the date of the approval this law by parliament. Commencing March 21, 1984, no bank was allowed to provide interest-based deposit or credit facilities. From March 1985, all banking transactions were strictly based on the Islamic Shariah.[3]

It's very important to note here that there was another financial institution in Iran which offered banking facilities but which was beyond the supervision of the

---

1 Pourian, Heydar, *The Problems of Nationalised Islamic Financial System: The Case of the Islamic Republic of Iran.* A research presented at the International conference on Islamic Banking, Sydney (Australia): November 1993, P.7.

2 Hedayati, S. Asghar, *Islamic Banking; the experience of the Islamic Republic of Iran,* a research presented at the International Conference on Islamic Banking, Sydney (Australia): November 1993, p.6.

3 Aryan, Hossein, *Iran: The Impact of Islamisation of the Financial System,* London (UK): Rodney Wilson, 1990, pp. 155-170.

central bank. This institution was the Islamic Economic Organisation (IEQ), which was originally an Islamic bank and was established immediately after the revolution to undertake interest-free banking activities. Following the directive of the late Imam Khomeini, this institution was excluded from nationalisation. Being independent from central bank supervision, this institution has its own policy and in most cases is not tailored to the monetary policy of the government.[1]

6.2.2 BANKING LAWS FOR CONTROLLING THE ISLAMIC BANKS IN IRAN:

The law for usury-free banking, which was agreed and passed in the Iranian parliament in August 1983, is considered as the main base for establishing, organising, and operating all the banking activities in Iran. This law contains 27 articles and can broadly be divided into the following five topics[2]:

- Objective and duties of the banking system in the Islamic Republic of Iran.
- Mobilisation of monetary resources.
- Banking facilities.
- Central Bank of Iran and monetary policy.
- Miscellaneous.

As required by Section 27 of this law, four more notes were issued and subsequently ratified by the Islamic Consultative Council. These notes are considered as part of the Usury-Free Banking Law. The first note was called Regulations Relating to the Mobilisation of Monetary Resources. It contains 12 articles and was issued on December 18, 1983. The second note, which was issued on January 4, 1984, consists of 76 articles. It is called Regulations Relating

---

1 Normani, Farhad, & Ali, Rahnema, *Islamic Economic System*, New Jersey (USA): Zed Books Ltd., 1994, pp. 112 - 117.

2 Central Bank of Iran, *Law for Usury-Free Banking*, Tehran (Iran), 1983. For more details, check the website of Central Bank of Iran at www.cbi.com, (Legislation).

to the Granting of Banking Facilities. The third note comprises four articles. It is known as Regulations Relating to Chapter 4 of the Law for Usury-Free Banking. The fourth note called Regulations Relating to Chapter 5 of the Law for Usury-Free Banking, it contains eight articles. Notes three and four were issued on March 7, 1984. This Law, together with these notes, illustrates the evolving process of Islamic banking in Iran.[1]

It is noticeable that the law and its annexes comprise all functions and activities that are performed by the Central Bank within the Islamic framework. It also elaborates the kinds of deposits the Iranian banks shall have to deal in. It explains the banking services and functions the Iranian banks can perform according to the Islamic system. This law also comprises the methods adopted by the central bank of Iran for controlling the Iranian banks and monitoring their activities.

Hereinafter we provide a detailed statement of the most important subjects the law comprises in connection with the basics of banking work in Iran, the Iranian banking system functions, and all that is connected with control on banks and the Iranian monetary policy.

(1) THE FUNCTIONS OF THE ISLAMIC BANKING SYSTEM:

The functions of the Iranian banking system are totally similar to those of any traditional banking system. However, there are certain functions in this system which were modified to conform with the teachings of the Islamic Shariah. The functions of the central bank connected with issuing the currencies, maintaining their value, their convertibility into other foreign currencies, the methods of dealing in silver and gold, extending loans, methods of banks control and the regulation of the Iranian monetary policies are all indicated and detailed within the

1 Iqbal, Zubair, & Mirakhor, Abbas, *Islamic Banking*, op. cit., p. 31.

paragraphs of the Law for Usury-Free Banking. If we follow the functions of the Islamic banking system in Iran, we find that they comprise the functions of the Central Bank as well as the functions of the rest of commercial banks. The following are its functions[1]:

1. Issuing notes and coins as legal tender.
2. Regulating, controlling and guiding the circulation of money and credit.
3. Performance of all banking operations in foreign exchange and local currency, and undertaking or guaranteeing the foreign exchange payments of the government.
4. Supervision of transaction in gold and foreign exchange and the inflow or outflow of Iranian currency and foreign exchange.
5. Performance of operations relating to valuable papers and documents.
6. Carrying out the monetary and credit policies.
7. Banking operations related to the parts of the approved economic plans which are to be conducted through the monetary and credit system.
8. Opening of various current and savings accounts and accepting term investment deposits and issuance of relevant certificates.
9. Granting of loans and credits free of interest.
10. Conducting transactions in gold and silver and holding and managing the foreign exchange and gold reserves.
11. Holding the Rial balances of international monetary and financial institutions or similar organisations and their affiliates.
12. Entering into payments arrangements in order to effect monetary, trade and transit agreements concluded between the government and other countries.

---

1 Amin, S.H., *Islamic Banking and Finance: The experience of Iran*, op. cit., p. 20

13. Accepting and holding in trust of gold, silver, valuables, securities and official documents for real or legal persons and leasing of safe-deposit boxes.
14. Issuance, confirmation and acceptance of Rial or foreign exchange guarantees for customers.
15. Performance of the services of attorney or guardian.

As it can be seen, the above functions cover various services rendered by the central bank, the commercial banks and the specialised and development banks. They are exactly the same functions performed by the conventional banks with the exception that the Islamic system does not permit the imposition of interest on loans.

(2) THE TYPE OF DEPOSITS IN THE IRANIAN BANKING SYSTEM:

The deposits in the Iranian banking system differ from deposits in the other traditional banking systems. This difference results from the nature of Islamic banking activities that do not deal with the banking interest. According to this law, banks were allowed to accept two kinds of deposits. These two kinds of deposits are as follows:[1]

a- Qard al-Hasan deposits: In the context of this law, Qard al-Hasan constitutes current and savings deposits as in the conventional banking system, except that they earn no returns. The banks can, however, offer some incentives to attract such savings deposits such as exemptions from the payment of commissions and fees, or giving them the priority in using the banking facilities.

These two kinds of deposits (Current and Savings Accounts), which fall within the Qard al-Hasan, are considered as a part of bank's resources.

---

[1] Hedayati, S. Asghar, *Islamic Banking as Experienced in the Islamic Republic of Iran*. Op. cit., 1993, p.21.

b- Term investment deposits: Banks are authorised to accept two types of investment deposits, short-term and long-term. The deposits differ with respect to the minimum required time limits, three months for short-term and one year or more for long-term deposits, and with respect to the minimum amount required. It is in amount of Rials 2,000 for short-term and Rials 50,000 or more for long-term accounts and all investment deposits are treated as depositors' resources. The law also states that funds in investment accounts be mobilised via the following interest-free means: joint venture, Mudaraba, hire-purchase, installment transaction, Mozaraah, Mosaqat, direct investment, delayed dealings and joalah transactions.

The next table shows the improvement of the short and long term deposits in the Iranian banking system from the year of 1999 to 2003.[1]

Table No. 6.7

Breakdown of Deposits in Iranian Banking System

(In billion of Iranian Rials)

Year / Description	1999	2000	2001	2002	2003
Short-term deposits	39,564.00	50,442.80	66,983.00	88,452.60	119,809.0
Long-term deposits	39,968.00	52,920.80	74,083.5	97,409.80	131,929.2
Total	79,532.00	103,363.60	141,066.50	185,862.4	251,738.2

1 The source is some statistical data obtained by the researcher by means of e-mail exchanges with the economic researches department in the central bank of Iran in January 2005 at mohdamorallah@cbi.com.

These two types of deposits became important tools to the central bank in controlling and monitoring the economic activities in the state. It gives indications to the monetary authorities about the volume of the money in the market. Therefore, by monitoring and controlling these two types of deposits, the central bank can play its normal role in the country and control the banking activities.[1]

(3) BANKING FACILITIES IN IRANIAN BANKING SYSTEM:

The banking services that the central bank of Iran allowed the commercial banks under its jurisdiction to employ are numerous and diverse. They are the Islamic investment and finance methods the Iranian banking system approved and imposed on all banks under its jurisdiction. Every economic activity has one or more banking services appropriate for it. If we follow the articles of the Law for Usury Free Banking, which is considered the basis of Islamic banking transactions in Iran, we will find that it comprises various Islamic investment and finance methods through which the Iranian banks can offer banking services. The following table indicates particulars of the types of banking services extended by the Iranian banks during the past five years and the amounts offered under each of these types[2]:

---

1 Alavi, Waheedullah, *the Impact of new banking system on the instruments of the Monetary and Credit Policy in Iran*, a research presented to the International Seminar and Islamic Banking, Tehran (Iran): June 1986, p.5.

2 The source is a statistical data obtained from the economic researches department in the central bank of Iran in January, 2005.

Table No. 6.8

Islamic Banking Facilities Extended To Non-Public Sector In Iran

(In billion of Iranian Rials)

Year/ Description	1999	2000	2001	2002	2003
Sale By Installments	80,025.00	107,665.40	148,370.30	201,087.40	281,259.20
Civil and Legal Partnership	17,354.0	21,411.30	24,262.10	24,793.60	36,894.30
Modarabah	8,391.00	10,885.80	13,095.90	18,167.20	27,450.90
Joalah	2,267.00	2,756.50	3,748.70	4,640.40	6,899.40
Delayed Transaction	8,970.00	12,401.10	17,755.70	21,498.50	26,871.50
Qard Hassan	6,100.00	7,507.50	10,643.80	23,001.60	25,794.90
Hire Purchase	813.00	1,107.60	1,580.10	3,400.30	5,278.30
Direct Investment	2,009.00	2,103.70	2,228.50	2,594.10	3,784.80
Debt Purchase	15.00	25.10	19.90	53.00	258.50
Others	8,104.00	11,043.30	15,745.20	21,560.10	27,905.80
Total	134,048.00	176,907.30	237,450.20	320,796.20	442,397.60

From the above table, it is noticeable that the types of banking services offered by the Iranian banks are those mentioned in the Law for Usury Free Banking, and which are according to the following details:

(1) SALE BY INSTALLMENTS (BAI TAQSEET):
This method of Islamic investment and finance is largely used in the Iranian banking system and it was permitted by the central bank of Iran in many economic transactions and activities. The central bank of Iran permitted this method in the housing, industrial and agricultural activities and services. This method was permitted in mines and mining activities through the purchase of commodities, goods and movable assets by the Iranian banks upon the request of customers and their undertaking to buy back through the sale

on installment method. This method is corroborated in article (11) of the Law for Usury Free Banking as follows: 'In order to create conditions necessary for the expansion of activities in industry, mining, agriculture and services, the banks are empowered - upon the request of the customer and his undertaking for the purchase, consumption or direct use of goods or commodity thus requested - to purchase movable property, and to sell them to the customer, on secured basis, on installment'[1]. Therefore banks are authorised to purchase raw materials, machinery, residential housing and equipment for firms and resell the same to them on installment. The price of the product subject to this transaction is to be determined on a cost plus basis.[2]

It is noticeable from the table no.6.8 that the method of investment and finance through the sale on installment transactions represented the largest percentage in the investment and finance transactions offered by the Iranian banks during the last five years. During these years they represented a percentage exceeding 60% of the total Iranian bank transactions. In the year 2003, they were 281.3 billion Iranian rials, the equivalent of 63.6% of the total investment and finance transactions in the Iranian banks[3].

(2) INVESTMENT PARTNERSHIP METHOD (MUSHARAKAH):

The investment partnership method is considered one of the Islamic investment and finance methods that the central bank of Iran permitted and authorised the Iranian banks to deal with third parties in certain projects and investments with the aim of expanding the productive and commercial activities as well as the services sector in the country.

---

1 Central Bank of Iran, *law for usury-free banking*, op. cit., Article (11).

2 Iqbal, Zubair, & Mirakhor, Abbas, *Islamic Banking*, op. cit. p.11.

3 The source is a statistical data obtained from the economic researches department in the central bank of Iran in January, 2005. Refer to table no. 6.8, P. 266 of this research.

Articles No. 7 and 8 of the present law comprise a provision to that effect[1]. In Article 7 it is mentioned that 'in order to bring about the necessary conditions for the expansion of the activities of various productive, commercial and services sectors, the banks may, on the basis of partnership, provide a portion of the capital or resources required by these sectors'. Article 8 says, 'The law for Usury-Free Banking recognises two different form of partnership - civil and legal. The civil partnership is a project specific partnership of short duration in commercial, production, and services activities in which each partner provides a share of the necessary capital, and the assets and properties thus acquired are held as community property until the term of the partnership. The second form of partnership is a firm specific venture of longer duration in which the bank provides a portion of the total equity of newly established firm or buys into an existing corporation'.

The central bank of Iran divided the types of partnerships in which the Iranian banks are allowed to enter into two: the legal partnership which represents Iranian banks' partnership in the Iranian joint stock companies, and the civil partnership which represents Iranian banks partnership in all other economic activities. Articles No. 18 to 27 of the circular issued by the central bank of Iran dated January 4, 1984, concerning the banking facilities determined the mechanism of working by this method and the conditions of using it[2].

Table No.6.8 makes it obvious that the investment partnership transactions come second in rank in terms of order of investment and finance transactions in the Iranian banks, next to the sale on installments method during the

---

[1] Central Bank of Iran, *law for usury free banking*, op. cit., Articles (7) & (8).

[2] Central Bank of Iran, *Regulations relating to the granting of bank facilities*, January 4, 1984, Articles (18 - 27).

last five years. In 2003, they reached the level of 36.9 billion Iranian rials, equivalent to 8.3% of the total investment and finance transactions in the Iranian banks[1].

(3) FORWARD DELIVERY TRANSACTION (SALAM):

The forward delivery method is largely used in the Iranian banking system. The laws of the central bank of Iran urge facilitating the use of this method in the Iranian banks in the investment and finance transactions connected with the production transactions. Articles No. 40 to 46 of the circular issued by the central bank of Iran dated January 4, 1984, concerning the banking facilities determined the mechanism of this method and the conditions for using it[2].

It is noticeable from table No. 6.8 that this method was largely used by the Iranian banks during the last five years. The forward delivery transactions come third in rank in terms of order of the Iranian banks transactions after the sale on installments and partnership methods. It represented a percentage ranging between 6.1% and 7.5% of the total investment and finance transactions in the Iranian banks during the last five years. It reached, in 2003, a level of 26.9 billion Iranian rials, which is equivalent to 6.1% of the total investment and finance transactions in the Iranian banks[3].

(4) SPECULATION TRANSACTIONS (MUDARABAH):

Since most commercial transactions in the companies and institutions in the Islamic economic system take place through speculation transactions, the central bank of Iran permitted the Iranian banks to deal in speculation transactions with third parties. Like, for instance, the

---

1 Refer to table no. 6.8, P. 266 of this research.

2 Central Bank of Iran, *Regulations relating to the granting of bank facilities*, January 4, 1984, Articles (40 - 46).

3 The source is a statistical data obtained from the economic researches department in the central bank of Iran in January, 2005. Refer to table no. 6.8, P. 266 of this research.

bank enters as a speculator with the depositors' funds or enters as owner of the fund in a speculation transaction with third parties such that these parties represent the role of the speculator. The objective behind permitting other banks to enter into speculation transactions was the expansion of commercial activities in line with the framework of the government trade policies. The Iranian banks put their financial resources in the service of their customers through the speculation transaction. Article 9 of the Law for Usury Free Banking asserts that 'in order to provide facilities required for the expansion of commercial activities, the banks may, within the framework of the commercial policies of the government, put the necessary financial resources at the disposal of the customers on the basis of Mudarabah'[1].

It is obvious from table no. 6.8 that the speculation transactions come fourth in rank in terms of order of the Iranian banks transactions next to sale on installments, partnership, and delayed delivery methods. They reached, in 2003, the level of 27.5 billion Iranian rials, the equivalent of 6.2% of the total investment and finance transactions in the banks[2].

(5) INTEREST-FREE LOANS:

The central bank of Iran asked all Iranian banks to use the interest-free loans in some of the facilities extended to customers. The banks are obliged to appropriate a percentage of their resources for this purpose. They are required to set aside a portion of their resources to extend interest-free loans to small producers, entrepreneurs, and farmers who would otherwise be unable to find alternative sources of financing and working capitals for their projects. Banks are

---

1 Central Bank of Iran, *the law for usury-free banking*, op. cit., Article (9).

2 Refer to table no. 6.8, P. 266 of this research.

permitted to charge a minimum service fee to cover the administrative cost.[1]

Articles No. 15 to No. 17 of the circular issued by the central bank of Iran dated January 4, 1984, concerning banking facilities determined the mechanism of working by this method and the conditions of employing it[2].

The interest-free loans method was used within the banking facilities methods used in the Iranian banks. It is noticeable from the table No. 6.8 that this method was largely used in the Iranian banks during the last five years as compared to the other investment and finance transactions. The facilities extended through this method represent a percentage ranging from 4.2% to 7.2% of the total investment and finance transactions in the Iranian banks during the last five years. It reached in year 2003 the level of 25.8 billion Iranian rials, equivalent to 5.8% of the total investment and finance transactions in the Iranian banks[3].

(6) DIRECT INVESTMENT:

The central bank of Iran allowed the Iranian banks to enter into direct investment with specified conditions, as in Article 8 of the Law for Usury Free Banking. The provision prescribed for such an investment requires[4] the banks to directly invest in productive and development projects. Banks can undertake to invest directly in any economic activities they choose after meeting the following requirements:

---

1 Iqbal, Zubair, & Mirakhor, Abbas, *Islamic Banking*, op. cit., pp. 31-43.

2 Central Bank of Iran, *Regulations relating to the granting of bank facilities*, January 4, 1984, Articles (15 - 17).

3 The source is a statistical data obtained from the economic researches department in the central bank of Iran in January, 2005. Refer to table no. 6.8, P. 266 of this research.

4 Central Bank of Iran, *Law for usury-free banking*, op. cit., Article (8).

- Banks cannot invest directly in projects in conjunction with the private sector and in projects that lead to production of luxury and unnecessary commodities.
- The ratio of the initial capital of these ventures to total funds must not be less than 40 percent.
- The total fixed capital necessary for undertaking these projects must be provided for by long-term financial resources.
- Undertaking of direct investment by banks must be based on well-documented evaluation and appraisal of the project. Use of bank resources and the expected return from these projects is sufficient to meet the minimum required rate designated by the central bank.

As mentioned in table no. 6.8 the direct investment transactions were used in the Iranian banks during the last five years represented a low percentage of the total volume of investment and finance transactions in the Iranian banks. They reached in the year 2003 the level of 3.8 billion Iranian Rials, equivalent to 0.9% of the total investment and finance transactions in the Iranian banks[1].

(7) HIRE-PURCHASE TRANSACTIONS:

The central bank of Iran allowed the Iranian banks to deal through hire-purchase method to expand the housing activities in a way conforming to the plans set by the Ministry of Housing and Rural Activities. This is indicated in Article 10 of the Law for Usury Free Banking[2]: 'For the purpose of providing facilities necessary for the expansion of housing activities, the banks may, in coordination with the Ministry of Housing and Town Planning, construct low-priced residential units for sale on installment or hire-purchase'.

---

1 Refer to table no. 6.8, P. 266 of this research.

2 Central Bank of Iran, *Law for Usury-Free Banking*, op. cit., Article 10.

The central bank of Iran also permitted the banks to use hire-purchase method in the agricultural and industrial activities as well as the mines and mining activities by buying movable and immovable assets upon request from customers and on undertaking by them to hire-purchase these assets. A provision in Article 12 of the law stipulates that the banks may create the necessary facilities for the expansion of services, agriculture, industrial and mining activities. They may purchase movable and immovable properties at the request of the client and his undertaking to hire-purchase the same for his own use, and place them at the disposal of the client in accordance with hire-purchase arrangements'[1].

In hire purchase transactions banks can purchase the needed machinery and equipment or other movable and immovable property, and lease them to firms. At the time the contract is entered into, firms have to guarantee to take possession of such property at the end of contract period.
According to the instructions of the Iranian central bank, banks cannot engage in hire transactions in which the useful life of the property is less than two years.[2]
It is obvious from the above table No. 6.8 that the hire purchasing transactions represented a low percentage of the total investment and finance transactions extended by the Iranian banks. They reached in 2003, the level of 5.3 billion Iranian Rials, equivalent to 1.2% of the total transactions in the Iranian banks[3].

(8) TRANSACTION BASED ON COMMISSION (JOA'ALAH):
The method of transaction based on commission is one of the investment and finance methods used in the Iranian banks. The directives of the central bank of Iran necessitate that

---

1 Ibid, Article (13).

2 Iqbal, Zubair, & Mirakhor, Abbas, *Islamic Banking*, op. cit. p11.

3 Refer to table no. 6.8, P. 266 of this research.

the Iranian banks shall use this method for the purpose of expanding the productive, commercial and services activities. Article 16 of the law of the central bank of Iran say: 'In order to provide the necessary conditions for the expansion of productive, commercial and services activities, banks may engage in Joa'alah'.[1]

According to Joa'alah transaction, banks may provide or acquire services whenever they are needed and charge or pay commissions or fees for such services. These fees and services must be determined at the time of the transaction.

Although the transactions based on commission that took place in the Iranian banks increased annually between 1999 and 2003, yet they are still low as compared to other investment and finance transactions. The transactions based on commission during the last five years represented the equivalent of about 1.5% of the total transactions. These transactions reached in the year 2003, the level of 6.9 billion Iranian Rials, equivalent to 1.6% of the total investment and finance transactions in the Iranian banks[2].

(9) OTHER METHODS:

There are other finance and investment methods that the central bank of Iran permitted and authorised the Iranian banks to offer banking facilities. Of these methods is the Murabaha sales method in some commercial activities, the manufacturing method (Istisna'a) in some of the industrial and contracting activities, and the Wakalah contract method, in addition to Mozara'ah, and Mogharasah methods with respect to the agricultural activities. The central bank of Iran prompted the Iranian banks to acquire the agricultural lands, machines and equipment and their investment by the farmers using Mozara'ah and Mogharasah methods. The bank

---

1 Central Bank of Iran, *Law for usury free banking*, op. cit., Article (16).

2 Refer to table no. 6.8, P. 266 of this research.

offers the land or the machine, the farmer works on land or uses the agricultural machine. Then the crop or production yield is distributed between the two parties in proportions previously agreed upon by them according to the limits determined by the central bank of Iran. In Mogharasah also banks may provide orchards or trees that they own or that are otherwise in their possession to farmers for a specific period of time and at a predetermined share of the harvest. The main target of the central bank of Iran behind activating investment by Mozara'ah and Mogharasah methods was to expand agricultural production and employing the Iranian farm labor. The following provision is prescribed in Article 17 of the Law for Usury Free Banking as follows, which says: 'The banks may assign on Mozara'ah or Mosaqat agricultural lands and/or orchards which are at their disposal or in their possession[1]

As set forth in the table No.6.8, the banking facilities that were extended in Iranian banks under the name of 'other transactions' - including Mozara'ah and manufacturing (Istsna'a) and others - formed in totality a good percentage of the total value of the extended banking facilities. They represented a percentage ranging between 6.1% and 6.7% of the total investment and finance transactions in Iranian banks during the last five years. They reached in 2003, the level of 28.2 billion Iranian Rials, equivalent to 6.4% of the total investment and finance transactions in the Iranian banks [2].

6.2.3 BANKING CONTROL AND THE MONETARY POLICY IN IRAN:

The central bank of Iran uses several methods in controlling the Iranian banks and implementing the monetary policy in the state. All these methods and tools that the bank uses are in conformity with the teachings of the Islamic Shariah.

---

1 Central Bank of Iran, *Law for usury free banking*, op. cit., Article (17).

2 Refer to table no. 6.8, P. 266 of this research.

The central bank of Iran, by controlling the Iranian banks, aims at achieving the following targets[1]:

1) Ensuring a safe and secure banking system
2) Efficient allocation of credit
3) Protecting the customer
4) Providing competition
5) Implementing the monetary policy

Since the application of these control methods and tools in 1979 until today, these methods have proved highly efficient in control operations on banking activities and in regulating the monetary policy of the state within the desired and safe limits.

The monetary authorities in Iran use various means and tools in supervising the banks for controlling the monetary policies of the state. These tools and methods are similar, from the point of view of effect and result, to the traditional monetary policy tools. They, however, differ from the traditional methods in their non-dependence on the banking interest or discount prices. But they determine the profit margin in different transactions carried out by the Iranian banks either through speculations, partnerships, sharecropping, sale on installments, or others. If the target of the monetary policy of the state aims at expanding the extension of credit and banking facilities, then it will reduce the banks' profit percentage. This leads to a rush of customers and those dealing with the banks to avail of the facilities and getting finance for their projects. Thus, the economic activity and, consequently, the production will increase. The opposite occurs when the monetary policy of the state is deflationary and its aim is to limit the banking machinery in granting the facilities. Hence, the monetary authorities will determine the share of the banks in the transactions profits at high levels. This will limit the flow of customers and those dealing with the banks for

---

1 Haron, Sudin & Shanmugam, Bala, *Islamic Banking System; concepts & applications*, op. cit., p. 154.

financing their projects and transactions. Consequently, bank facilities become costly due to the increase of the banks profit share from the different projects and transactions.

By determining the banks' profit share and their partnership percentage, the central bank of Iran maintains quantitative control on the extension of credit and credit facilities.

Through qualitative control on credit and credit facilities, the central bank of Iran directs the banks facilities to specific activities and deviates them from non-desired activities as per the country's needs and the directives of the monetary and economic policy. Thus, we notice that the central bank of Iran interferes in determining the share of the Iranian banks in different transactions and economic activities, whether in the partnership percentage or in the banks' percentage in the profits. If the target of the central bank of Iran is directing the banking facilities towards a specific activity, agriculture for instance, it raises the limit of the banks' minimum percentage of contribution to the agricultural projects. The opposite will occur when the monetary authorities desire to dissuade banks from granting facilities to a certain sector. They lower the level of the banks' minimum percentage of partnership in these transactions and, consequently, raise the banks' profit percentage from the transactions in this sector. Those dealing with the banks will refrain from requesting facilities for that sector and the finance facilities will consequently be directed, instead of that sector, to other lower-cost sectors.

On reviewing the Law for Usury-Free Banking, we notice that it comprises several items aimed at tightening control on the Iranian banks and controlling the economic activities and the general monetary policy of the country. According to Article no. 20 of the Law for Usury-Free Banking, the central bank of Iran is empowered to intervene and control the monetary and banking activities though the following instruments[1]:

1) Fixing a minimum and maximum ratio of profit for banks in their joint venture and Mudarabah activities. These ratios may vary for different fields of activity.

2) Designation of various fields for investment and partnership within the framework of the approved economic policies, and the fixing of a minimum prospective rate of profit for various investment and partnership projects. The minimum prospective rate of profit may vary with respect to different branches of activity.

3) Fixing a minimum and maximum margin of profit, as a proportion to the cost price of the goods transacted, for banks in installment and hire-purchase transactions.

4) Determination of types and the minimum and maximum amounts of commissions for banking services and the fees charged for putting to use the deposits received by the banks.

5) Determining the types, amounts, minimum and maximum bonuses that can be granted by the banks.

6) Determining the minimum and maximum ratio in joint venture, Mudarabah, investment, hire-purchase, installment transactions, buying or selling on credit, delayed deals, Mozara'ah, Mosaqat, Joa'alah and Qard al-Hasan for banks or any with respect to various fields of activity. Also fixing the maximum facility that can be granted to each customer.

The Central Bank of Iran uses the instruments of monetary policy as outlined in the Monetary and Banking Law without contravening the provision of the Law for Usury-Free

---

1 Central Bank of Iran, *Law for Usury Free Banking*, op. cit., Article 20.

Banking. And for the effective implementation of the monetary and credit policies and the maintenance of currency value, the bank may intervene and supervise the monetary and banking operations with the approval of the Monetary and Credit Council by availing itself of the following measures[1]:

1) Determining the various fields for investment and partnership.

2) Determining the minimum and maximum projected rate of profit for the purpose of selection of investments or partnership projects.

3) Determining the minimum and maximum share of the profit for banks in Modarabah and in partnership.

4) Determining the minimum and maximum amount of facilities provided by the banks, from the investment deposits and the bank's own resources, for each area of activity.

5) Determining the maximum limit for each type of facility and total of facilities to be granted by one of several banks to any person, whether real or legal.

6) Determining the minimum and maximum limits of the remunerations of the various attorney functions in respect of the employment of investment deposits.

7) Determining the rules governing the minimum and maximum commissions for various banking services on the basis of the volume of tasks performed in respect of such services.

To control the banking system and implement a suitable monetary and credit policy in Iran, the central bank presents each year after the approval of government's annual budget by the Islamic Consultative Assembly a detailed

---

1 Amin, S. H., *Islamic Banking and Finance; the Experience of Iran*, op. cit., p. 23.

monetary and credit policy to the Money and Credit Council for approval. This procedure is followed in accordance with Article 19 of Usury-Free Banking Act of 1983. As a practical sample for what we stated above, we will show the items of the monetary and credit policy for 2004 that related to the banking activities approved by the Money and Credit Council. This policy consists of the following decisions[1]:

1- Banks are authorised to extend 35 percent of increase in outstanding of non-public sector facilities free from sectoral allocations. The share of various sectors that can meet urgent needs are shown in the following table:

Table No.6.9

Sectoral Allocation of Banking Facilities to Be Extended to Non-public Sector In Iran

Sector	Percent Per Annum
Agriculture	25%
Manufacturing and mining	33%
Housing	20%
Construction	8.5%
Export	9.5%
Domestic trade, services and miscellaneous	4%
Total	100%

2- The provisional profit rate of bank deposits is determined at the following levels:

Short term deposits at: 7%
Special short term deposits at: 9%
Long term deposits at: 13%-17%

3- Rate of return on banking facilities are set as shown in the respective table:

1 For more details check the website of Central Bank of Iran at www.cbi.com, (Legislation, monetary policy 1382).

Table No. 6.10

Rate of Return on Banking Facilities in Iran

Sector	Percent Per Annum
Agriculture	13.5%
Manufacturing and mining	16%
Housing (housing saving fund)	15%
Housing (without depositing)	18%
Export	15%
Commerce, services, construction and miscellaneous	21% (minimum)

The decisions of the aforementioned monetary policy provided us a practical example of the central bank of Iran's role in realising the control operations on the Iranian banking activities. These decisions show that the central bank of Iran imposes its power for distributing the finance portions to the economic sectors according to the needs of the country and the trends of its economic activities. These portions are not fixed, but vary from year to year.

The abovementioned monetary policy shows that the central bank of Iran determines the profit margin on the different banking deposits, whether they are short or long term. It also determines profit margin on the banking facilities the banks grant to their customers. Therefore, the control operations exercised by the central bank of Iran on the Iranian banks help it in maintaining and protecting the rights of depositors and in providing a suitable return on their deposits. These also help in controlling the cost of banking facilities granted by the banks within the safe level that realises competitive financing opportunities for their customers. Through the control operations, the central bank achieves the more general and comprehensive target by directing the economic activity of the state towards the aspirations of the general economic policy. This is done by refreshing some of the important economic sectors or reducing the support for others.

6.3 CONTROLLING SYSTEMS ON ISLAMIC BANKS IN PAKISTAN:

Pakistan is considered one of the first Islamic countries that abided by the Islamic teachings in managing its political, economic and social matters. Most of the citizens follow the teachings of the Islamic Shariah. This formed a strong incentive for Pakistani officials in implementing the Islamic economic system to all financial dealings of the government and the commercial banks operating within the country. The Pakistani Constitution promulgated in 1973 prescribed in its Article No. 227 that all the laws in force shall be modified in keeping with Islamic teachings. Article 31 of the Constitution provides for taking such steps as will enable Pakistani Muslims to organise their lives according to the basic principles and main concepts of Islam.[1]

Article 37 of the Pakistani Constitution, which deals with setting the Pakistani policy, called for the annulment of usury as fast as possible. Politicians and legislators confessed that the term usury is similar to the meaning of interest in all its features[2]. Unfortunately no attention was paid to the annulment of the interest during the first three decades following Pakistan's independence from India. The serious work towards setting the ways and means to annul the bank interest did not begin till the then Pakistani President General Zia-ul-Haq asked the Islamic Thought Council in September 1977 to prepare a preliminary non-usurious economic draft system. A period of three years was determined for gradually annulling the interest from

---

1 The Council of Islamic Ideology, *Elimination of Interest from the Economy*, supervised by Rafiq El Masry, Jeddah (Saudi Arabia): International Center for the Islamic Economic Researches, King Abdul Aziz University, 1984 [2nd. edition], P. 13.

2 Ibid, P. 13.

Pakistani economy[1]. This was the first step that began with the aim of transforming the Pakistani economy into an economy totally free of the banking interest. It was followed by other steps towards that target. When the Pakistani government decided to shift to the Islamic banking system, this decision threw a huge responsibility on the Central Bank of Pakistan. It shouldered the burden of realising this transformation from the banking system that depends on the banking interest to the Islamic banking system that annuls interest from all its dealings.

The report that was set by the Islamic Thought Council for annulling interest was of big benefit to the central bank as it helped its officials in comprehending the Islamic aspects of the transformation process. Moreover, the aforementioned report illustrated the general course to be taken for realising the Islamisation of the banking and financial system. A committee headed by the governor of the central bank also studied the problems involved in the process of transformation. In addition, the Central Bank of Pakistan formed work groups composed of the key officials in the banks and the developmental finance institutions for studying the technical aspects of the process of Islamising the banking and financial system. The reports issued by these groups assisted the central bank in treating the complicated problems that accompanied the process of annulling the bank interest from the banking transactions[2].

The efforts bore fruits. Many of the laws and systems were changed from the traditional system to the Islamic system,

---

[1] The Council of Islamic Ideology Council is a council founded by General Zia-ul-Haq in September 1977 in Pakistan. The council consists of 15 members among the best Pakistani scientists in the fields of economy, management, and Islamic sciences who enjoy the academic efficiency and experience. The purpose of the council is to prepare a preliminary system for Islamising the Pakistani system in order to cancel the interest from all its transactions.

[2] Haron, Sudin and Shanmugam, Bala, Islamic Banking System Concepts and Applications, Sdangor Darual Ehsan, (Malaysia): Pelanduk publications, 1997, PP. 18-23.

including the commercial banks systems, the central bank, the Pakistani companies system and all that is connected with the Pakistani government's relationship with the other countries, the international financial institutions or the local banks, including the Central Bank of Pakistan. A set of banking laws derived from the Islamic Shariah was drafted with regard to the local banks' operations and the activities and functions of the central bank. These systems and laws still represent the basis used by the Pakistani monetary authorities in regulating the work of Islamic banks. They also form the basis on which the central bank monitors and controls the Islamic banks operations regardless of the dominating economic system.

6.3.1 DEVELOPMENT STAGES OF THE BANKING SYSTEM IN PAKISTAN:

The stages and patterns that the Pakistani banking system passed through were multiple and diverse according to the prevailing political system in the country. The Pakistani banking system took the shape of one of the following patterns:

1) Traditional banking system
2) Islamic banking system
3) A mixed traditional banking system in some aspects and Islamic in other aspects

One of these three patterns would be strengthened and activated over the others according to the tendencies and directives of those in charge of managing the affairs beginning with the president or the prime minister passing through the legislative and executive agencies and ending with the financial and monetary authorities.

Since Pakistan's independence from India and until the present time a number of presidents and governments succeeded one another affecting and affected by the economic systems prevailing during their rule, including the banking systems and legislations, and the laws governing the central bank systems and its different functions.[1] Based on the past history, the researcher divides the Pakistani banking system into three main stages:

1) Stage of the banking system during the post-independence period
2) Stage of Islamising the Pakistani banking system during the regime of General Zia-ul-Haq
3) Stage of the mixed banking system following the regime of General Zia-ul-Haq

We provide here an outline of the details of these stages and the most important characteristics distinguishing them:

(1) STAGE OF THE BANKING SYSTEM DURING THE POST INDEPENDENCE PERIOD:

After independence, Pakistan inherited from India most of the systems and laws. The inherited banking systems and laws had western features and characteristics because of the influence of the English systems and laws during the British occupation. The economic system that prevailed during this stage was the traditional economic system based on the principle of banking interest. All banks and financial institutions operating in Pakistan were based on banking interest[2]. During this period, the main sections of the Pakistani system were composed of the State Bank of Pakistan, which is the Central Bank of Pakistan, the commercial and specialised banks. The Pakistani government, at that time, entrusted to the central bank the tasks of drawing, executing and controlling the monetary policy by employing the means and methods available to the Central Bank of Pakistan. The central bank depended on its multiple

1 Faruqi, Jalees Ahmed, *Islamisation of Banking in Pakistan*, Karachi (Pakistan): United Bank Limited, 1984, P. 45.

2 Siddiqui, Mohammed Najatullah, *Applying the laws derived from the Islamic Legislation on the banking work; A practical study on the Pakistani system*, Jeddah (Saudi Arabia): Scientific publication center, King Abdul Aziz University, 1988 [1st.edition], P. 67.

functions, means and methods of traditional feature in performing its role in connection with the monetary policies desired by the authorities[1].

By analysing the functions that Central Bank of Pakistan performed at that time, we found that they were similar to the multiple functions exercised by many central banks all over the world. Also, the qualitative and quantitative methods exercised by the central bank for drawing and executing the monetary policy during that period were similar to the means and methods widely used in most of the central banks. Yet some of these means and methods had a limited effect in Pakistan because the economy at that time lacked the required level of organisational factors and the power necessary for making these means and methods effectively applicable. As an example of that, the open market transactions exercised by many of the central banks were not applicable with effectiveness in the Pakistani economy and were not an effective weapon for controlling the credit due to the lack of a developed stock market in the state at that time and because the biggest portion of governmental bonds were held by the other banks and financial institutions[2].

During this period, Pakistani had a traditional economic system based on the banking interest. This situation continued until important transformations began to appear. The banking systems and legislations during the regime of General Zia-ul-Haq and the governments and parliaments formed during his age. Thus the stage of depending on the traditional banking system ended and a new stage began to appear, namely the stage of Islamising the Pakistani banking system.

---

1 Uzair, M., *Central Banking operations in an interest free banking system, Monetary and Fiscal Economics of Islam*, edited by Mohamed Ariff, Jeddah (Saudi Arabia): International Center for Islamic Economics, King Abdul Aziz University, 1982, P. 213.

2 The Council of Islamic Ideology, *Elimination of Interest from the Economy*, Op. cit., P. 22.

(2) STAGE OF ISLAMISING THE PAKISTANI BANKING SYSTEM:

This stage began in September 1977 when the late Pakistani President Zia-ul-Haq asked the Islamic Thought Council to submit and propose the broad outlines of an economy not depending on the banking interest. The Islamic Thought Council submitted its final report with its recommendations with regard to Islamising the Pakistani banking system in June 1980. This report proposed maintaining the basic structure of the banking system to be formed of the central bank as well as the commercial and specialised banks. The report further proposed modifying the method by which the banking system operates so that it depends on sharing the profit and loss instead of the interest. It proposed the banks to continue accepting current and saving deposits as they used to do before, providing they shall not pay any return on the current deposits and the return on saving deposits shall be determined with a percentage of the profits realised by the bank. The bank, according to this system, will offer finance to customers and companies without stipulating the interest. But it divides the profit with them based on an agreed percentage. The banks, under this system, will exercise the commercial activity using the different sale forms such as the term sale by installments, leasing sale, and Murabaha sale[1].

In the beginning of 1981, the Pakistani government started the process of actual transfer to the Islamic banking system. The Central Bank of Pakistan issued a circular to the commercial banks comprising 12 finance forms to replace transactions that depend on interest. These forms where divided into three sections[2]:

---

1 Haron, Sudin and Shanmugan, Bala, *Islamic Banking System Concepts and Applications*, op.cit., P. 18.

2 Siddiqui, Asrar H., *Practice and law of banking in Pakistan*, Karachi (Pakistan): Royal Book, 1983, P. 68.

1) Finance by loans: It comprises the soft interest-free loans and the loans comprising management costs;
2) Sales finance: It comprises Murabaha transactions, purchase for re-sale, leasing and lease-sale.
3) Investment finance forms comprising contracts of partnership, speculation, purchase of stock, lease contribution and term partnership certificates.

The relationship between the central bank and the commercial banks was changed so that it depends on new tools like controlling the percentages of profit and the right of determining minimum and maximum levels of commercial banks share in profits. The central bank also reserved all traditional tools of the monetary policy that do not depend on the interest. The government, in addition, amended a number of laws that were enacted on the basis of the interest. The amendments to the existing laws comprised the following:[1]

1) Amendments to the central bank law.
2) Amendments to the banking companies law. This law expanded the definition of guarantees, creditor and debtor. The law was also amended to allow banks to work in trade and some clauses connected with accepting the deposits on the basis of profit and loss were added to the said law;
3) Amendments to the law of commercial papers.
4) Amendments to the civil procedure law, presenting an alternative to the interest in case of the provisions that comprise a penalty clause for procrastinating in debt settlement;
5) Amendments to the exchange dealing and financial services law, providing a definition of the partnership contract. Finance within the Islamic

---

1 Siddiqui, Mohammed Najatullah, *Applying the laws derived from the Islamic Legislation on the banking works; A practical study on the Pakistani system* , op. cit., PP. 119-131.

contracts, was entered under the definition of loans, facilities and credit.

The Pakistani government enacted new laws for completing the process of Islamising the banks. The new laws were represented in the following[1]:

a) The law of speculation companies and speculation certificates circulation and control.

b) The banking arbitration law enacted in 1984 to facilitate examining the disputes and cases arising because of the application of the new banking systems.

During this stage, all activities of the banks operating in the country - whether commercial, specialised, or a central bank - became Islamic depending upon the profit and loss sharing principle, dismissing and prohibiting the interest. This stage lasted all through Zia-ul-Haq's tenure, and continued for a period after his death[2].

Despite the success of the experiment of Islamising the Pakistani banking system during this period, an important political group followed Gholam Ishaq Khan's tenure. A new command assumed the country's leadership, and called for returning to the traditional banking system. They separated the Islamic banking system and the traditional banking system. That step was considered the start of a new stage in the Pakistani banking system.

(3) STAGE OF MIXED BANKING SYSTEM:

The success witnessed by the Islamic banking system in Pakistan during the regimes of late presidents Zia-ul-Haq and Gholam Ishaq Khan began to decline after the emergence of secular governments calling for reverting to the traditional banking system. That was at the beginning of Benazir Bhutto's rule. The Pakistan People's Party (PPP)

---

1 Ibid., P. 194.

2 International Association of Islamic Banks, Journal of Islamic Banking and Finance, Karachi, vol. 6, No. 1, January, 1989, p.46.

started attacking some Islamic thoughts, including the subject of Islamic economic system. This was succeeded by exposure of the country to multiple economic and political problems that weakened the Islamic trend in the country, particularly in connection with the economic systems and activities of Islamic banks. Thus, several banks returned to the traditional banking system based on the banking interest. A number of Pakistani commercial banks preferred to maintain the banking dealing on Islamic basis. A number of speculation companies were established based on the speculation law which was enacted during the previous period and still operated according to the banking speculation run on the basis of profit and loss sharing[1].

The Central Bank of Pakistani divided its activity into two sections: one, to monitor the banks adopting the banking interest as a basis for their dealings; and the other, to monitor the banks that exercised the Islamic banking activity and also the Islamic financial institutions. This situation prevails till this present time. Now there are departments at the central bank to monitor and supervise the traditional banks, and others in charge of monitoring the activities of Islamic banks and Islamic financial institutions. Each section has its own laws that serve the monetary policy of the country[2].

Following the end of Benazir Bhuto's rule in 1996 and after Nawaz Sharief took over the reins of power, calls for made to return to the Islamic Shariah in all aspects of life, including the banking system. Therefore, the International Institute of Islamic Economy in Islamabad called for issuing a financial system to be applied to the country. That Islamic financial system was issued in the year 1999, but in

---

1 Khan, Abdu Jabbar, *Non-Interest Banking in Pakistan: Concept, Practice and Evaluation*, Karachi (Pakistan): Royal Book, 1991, P. 23.

2 Haron, Sudin, & Shanmugam, Bala, *Islamic Banking System, Concepts & Applications*, Op cit, P. 21.

December of the same year, the Supreme Court in Pakistan recommended that this Islamic financial system should be applied on June 30, 2001. However, after General Pervez Musharraf came to power in 2001, people started calling for shifting back to the traditional banking system. Those voicing this shift were particularly the officials of the traditional commercial banks that were active during that period, especially the United Bank. They called for postponing the application of the Islamic interest-free banking system until December 31, 2005.[1] Arguments in favor and against is raging: one calling for full application of the Islamic banking system to all Pakistani banking system agencies, and the other calling for keeping the traditional banking system.

At present Pakistan has a mixed banking system. There are traditional banks and financial institutions depending on the banking interest. At the same time, there are banks and Islamic financial institutions that follow Islamic Shariah by prohibiting the banking interest. There are also control divisions at present in the central bank that are in charge of supervising and monitoring the traditional banks, and control divisions in charge of supervising and monitoring the Islamic banks and financial institutions. It should be mentioned here that the control divisions in the central bank in charge of supervising and monitoring the currently existing Islamic banks and financial institutions use the banking systems, laws and regulations that were approved during General Zia-ul-Haq's regime dedicated to Islamising the Pakistani banking system.

Every now and then, amendments are made to suit the current conditions prevailing in the Pakistani society. The last amendments approved by the central bank to the Pakistani Islamic banking system were the introduction of multiple

---

1 Euromoney publications, *Islamic Finance; Innovation and Growth*, London (UK): Published by Euromoney Books, 2002, P.39.

unified forms and formulae in the Islamic finance contracts like a unified form of the speculation contract, murabaha contract, leasing deed, salam, partnership contract, contract for manufacturing (Istisna'a), and a contract for joint speculation transactions. The Islamic Authority of the central bank approved those Islamic finance forms which fully agreed with the teachings of the Islamic Shariah. These were presented to the governor of the central bank in April 2004 for implementation[1].

It should be mentioned here that the experiment of establishing speculation companies in Pakistan based on the law approved in 1980 concerning the control and supervision on speculation companies works is still operational. The speculation companies are considered another field for applying the Islamic banking operations.[2].

6.3.2 CONTROLLING LAWS AND THE MONITORY POLICY IN PAKISTAN:

Circular No. 13 by the Banking Control Department at the Central Bank of Pakistan on June 20, 1984, and its supplements were the main bases for the central bank to draft an effective and progressive law for the banks control system under an Islamic system in Pakistan. This circular is considered the first actual start of the basis of the Islamic banking system activities in Pakistan. It comprises, with its supplements, the basic steps the central bank adopts in performing its activities under an Islamic system and determines finance and investments formulae[3].

Other circulars were also issued by the central bank, which clarified more details about the Islamic banking basics that were applied in Pakistan. Circulars no. 26 and 34 issued on

---

1 Press release of the State Bank of Pakistan, Islamabad (Pakistan): April, 2004.

2 Archer, Simon & Karin, Rifaat *Ahmed, Islamic Finance Innovation and Growth*, Op. cit, P. 40.

3 Iqbal, Zubair & Mirakhor, Abbas, *Islamic Banking*, Washington D.C. (USA): International Monetary Fund, March 1987, P. 44.

November 26, 1984, and circulars no. 37 and 38 issued on December 10, 1984, are considered supplements to the previous circular no. 13 issued on June 20, 1984, and a clarification of some additional items concerning the Islamic banking system[1].

Over the years the Central Bank of Pakistan developed its methods and tools in controlling and monitoring the banks and financial institutions. It benefited by its experiments and experience until the present control and monitoring methods and tools became among the best in the Islamic world. Many Islamic countries adopted these tools and methods because of their efficiency and effectiveness.

Hereinafter, we will discuss the most important tools used by the Central Bank of Pakistan in controlling the Islamic banks and financial institutions in Pakistan and which were compatible with the teachings of the Islamic Shariah.

(1) LEGAL RESERVE RATIO:

This is considered one of the important monetary tools in setting the monetary policy. It is used under the Islamic banking system as is the case with the traditional banking systems. The Central Bank of Pakistan, under the Islamic banking system, applied the policy of legal reserve. It committed all banks operating under its supervision to maintain with it a minimum percentage at the equivalent of 5 percent from the total deposits on demand or term liabilities. No need has been felt to change this demand since then, as the percentage remains applicable till this date[2].

Under the traditional banking system, the Central Bank of Pakistan used to impose on the bank that does not abide by the minimum required level of the monetary reserve with it

---

1 Haron, Sudin, & Shanmugam, Bala, *Islamic Banking System, Concepts & Applications*, Op cit, P. 154.

2 Sidiqui, Mohammed Najattullah, *Applying the laws derived from the Islamic Legislation on the banking works; A practical study on the Pakistani system* , op. cit., P. 134.

to pay an interest for the missing amount at an interest rate exceeding the bank rate but within the limits of 3-5%. Under the Islamic banking system, the Central Bank of Pakistan changed this penal interest with another penalty. They imposed daily fees on the non-paid amount as a value and not as a defined percentage for interest.

(2) LIQUIDITY RATIO:

The liquidity percentage is considered among the monetary policy tools that affect the ability of banks to finance the private sector. They are applied to the Islamic banks in the same way as with the traditional banks.

This was used as an Islamic tool by the Central Bank of Pakistan in controlling and directing the banks operating in Pakistan. The Central Bank of Pakistan defined the liquidity percentage as equivalent to 35% of the current or term liabilities of each bank in Pakistan. This percentage cannot be changed except in specified cases and for a period of time. The level is restored once the specified cause is fulfilled.

(3) THE TOTAL CEILINGS OF THE FINANCING AND INVESTMENT TRANSACTIONS IN THE BANKS:

The Central Bank of Pakistan uses this policy as an important tool to control and direct credit. It divided the economic sectors in the country into categories and determined for each category a certain ceiling of the total financing and investment transactions. The central bank may increase the ceiling for sectors it desires the banks to turn to in the loaning or investment transactions. It may decrease the ceiling for sectors it does not wish the banks to turn to.

Previously, this tool was used by the Central Bank of Pakistan efficiently and effectively in controlling and directing the Pakistani banks and financial institutions. The central bank used to set for each economic activity or sector maximum ceilings as a percentage of its total loans that no bank or financial institution can exceed in the financial transactions. The loans of the agricultural sector used to get high ceilings. External trade and industry also got high ceilings on loans. The Central Bank of Pakistan considered that increasing the finance in these sectors would augur well for the Pakistani economy.

Statistics available with the central bank assures the diversity of economic sectors and activities that obtained high finance ceilings. The basis that the central bank uses in determining the amount of these ceilings between various economic activities every year depends on the high economic policy directives and the economic situation prevailing at that time. The Central Bank of Pakistan is still using this method as an Islamic tool in controlling the Pakistani banks and financial institutions. It uses this method in the case of the traditional banks as well[1].

(4) MANDATORY TARGETS FOR FINANCING PRIORITY SECTORS:

The Central Bank of Pakistan determined mandatory targets for the commercial banks to ensure the provision of the finance amounts appropriated for certain economic sectors to help in realising the country's social and economic targets. The Central Bank of Pakistan determined targets for the commercial banks operating in the country connected with the small loans for trade and industry, and for agricultural production, loans for fixed investment in agriculture and the low-cost housing loans. The central bank used this method for controlling and directing the Pakistani banks as one of the monetary policy tools compatible with the teachings of the Islamic Shariah. The Central Bank of Pakistan issued the instructions to the banks and financial institutions to motivate them to finance small farmers and fishermen. It also used to oblige these banks and financial institutions not to impose any duties on these loans in case the borrower settles the amount of the loan within the

1 Ibid, P. 132.

agreed period. The government pays the profit amount resulting from the Murabaha transaction to the banks by recording it on the debit side of the federal government account with these banks[1].

(5) DIRECT INSTRUCTIONS AND MORAL CONVICTION:

The Central Bank of Pakistan, besides its authority to imposing qualitative and quantitative control arrangements on credit, enjoys the power of issuing direct instructions to the banks in general or to a determined bank on any matter. The central bank may urge a bank to increase the credit to a certain sector or category of the economic sectors or vice versa. It may ask a bank to finance or refrain from financing a specific project.

The Central Bank of Pakistan used this method with most of the banks operating within its powers as a means to direct and control the banks and the credit limit in them. The Central Bank of Pakistan, by virtue of direct instructions from it, obliged some of the banks operating within the range of its supervision to set a system that determines the minimum and maximum limit of partnership percentages in the profits of investments carried out by these banks.[2]

(6) DETERMINING THE PERCENTAGE OF PROFIT SHARING:

The Central Bank of Pakistan substituted the traditional tool termed as 'bank rate' by an Islamic tool it considered as an alternative. It performs a role in economy similar to that performed by the bank rate. This new tool is known as partnership percentages. The Central Bank of Pakistan, by virtue of this policy, determines the percentages of its profit share for the financial aid it offers to the other

---

1 Council of Islamic Ideology, *Elimination of Interest from the Economy*, Op. cit., P. 81.

2 Siddiqui, Mohammed Najattullah, *Researches on the Islamic Banking System*, Jeddah (Saudi Arabia): Scientific Publication Center, King Abdul Aziz University, 2003, P. 196.

banks and financial institutions in supporting them at the time of their need for liquidity. The Central Bank of Pakistan resorted to changing these partnership percentages from time to time and from one region to another and set maximum and minimum limits for the partnership percentage in the finance profits granted to the banks and financial institutions.

The Central Bank of Pakistan obliged the other Pakistani banks and financial institutions to depend on the determined partnership percentages in offering aids or finance to each other or to their customers. The central bank issued directives to the banks and financial institutions that profit and loss shall be connected with the profit-loss ratio of the granted finance to the total amount of the funds employed during the year or during any other period agreed upon. The fair percentage of profit and loss from the total employed funds shall be resorted to by using the method of points. The Central Bank of Pakistan determined the profit sharing percentage as follows[1]:

Sector or purpose	Minimum Level	Maximum level
1) Industry		
a. Industrial investment	40%	50%
b. Working capital	55%	65%
2) Exports, small projects, And industry	10%	20%
3) All the other sectors or Purposes	60%	70%

According to the bulletins issued by the central bank, the policy of setting maximum and minimum limits to the sharing percentages and binding the banks and financial institutions by them enables the bank offering the finance to set terms and provides a measure of competition between banks. The

---

1 The Council of Islamic Ideology, *Elimination of Interest from the Economy*, Op. cit., P. 83.

policy is considered one of the Central Bank's methods of directing the interests of the banks and transforming them into a certain economic sector that the Central Bank desires to activate and motivate by raising the profit-sharing percentage in it. The Central Bank may wish to divert the other banks from undesired economic sectors by reducing the profit-sharing percentages.

(7) OPEN MARKET OPERATIONS:

The traditional banks resort to the policy of buying and selling bonds from and to the banks and financial institutions for controlling the credit and directing the capability of the banks to either retain or dispose of certain liquidity. The Central Bank of Pakistan substituted the transaction of buying and selling the bonds by an Islamic alternative. It issued bonds with changing profits by the central bank so that the bondholders share with the central bank the profit and loss generated from the bond-issuing process transaction.

At the end of this part of the research, it is necessary to outline that the Pakistani experiment in applying the Islamic banking system is considered successful and an example to be followed by several banking systems in the Islamic world. Even the international monetary authorities acknowledged the validity and quality of this system. This was clearly mentioned in the International Monetary Fund's publications[1]. Many of the central banks in Islamic countries derived from the Pakistani banking system several rules, methods and functions that were later modified according to the economic conditions in the country.

6.4 CONTROLLING SYSTEMS ON ISLAMIC BANKS IN SAUDI ARABIA:

The Kingdom of Saudi Arabia is considered one of the most important Islamic countries that applies the provisions of the Islamic Shariah in all aspects of life. The officials

---

1 Iqbal, Zubair & Mirakhor, Abbas, *Islamic Banking*, Op. cit., P. 44.

here declare their abidance by the teachings of the Islamic Shariah. Saudi citizens and a huge percentage of expatriates abide by the Islamic Shariah. The financial dealing is considered the most important facet in the people's dealings with each other. Therefore, a big percentage of Saudi citizens and expatriates are keen on abiding by the Islamic Shariah with regard to the method of earning, investing, managing and spending money.

In the Kingdom of Saudi Arabia several financial and banking institutions exist and operate on the teachings of the Islamic Shariah. These institutions try to offer banking products conforming to the Islamic Shariah.

6.4.1 STAGES OF HISTORICAL DEVELOPMENT OF SAUDI BANKING SYSTEM:

The Saudi Arabian Monetary Agency (SAMA) is the Central Bank of the Kingdom of Saudi Arabia. Although it does not carry the name of a bank, yet it performs all the tasks of a central bank. Since its establishment, SAMA took the initiative of supervising the activities and accounts of the banks. In most cases, they were branches of Arab, European, Asian and American banks that later turned into joint Saudi companies the capital of which is financed by contribution from the Saudi private sector and the foreign capital.

The emergence of banks in the Kingdom of Saudi Arabia dates back to the beginning of the 20^{th} century. At that time, they were simple. Historians divide the phases of banking system in the Kingdom of Saudi Arabia into four main periods[1].

---

1 Hamed, Sayed Mohamed, *the development of the Central Banking System in the Kingdom of Saudi Arabia*, translated by Hassan Yasseen, Riyadh (Saudi Arabia): General Management Institute, consultations & Researches department, 1979, P. 167.

(1) BANKING FORMATION STAGE:

This period began in 1926 and ended in 1932. It is the period that followed the unification of the Kingdom of Saudi Arabia under the name of the Kingdom of Hejaz and Najed and their auxiliaries when the government of the Kingdom established the Public Treasury Administration in 1926 to assume the management of all financial and monetary affairs of the country. This administration issued a number of financial and monetary systems. The first of this were the Hejazi Najdi Monetary Systems in 1927. This comprised many provisions connected with the Saudi currency, its minting and managing its affairs in terms of exchanging and controlling it. During that period, the first commercial bank came into being. This bank was established under the name of Dutch Commercial Company in the year 1926. Then its name was changed to General Dutch Bank, which exists till this date under the name of Saudi Dutch Bank.[1]

(2) PREPARATION AND ADAPTATION STAGE:

This period began in 1932 during which year the General Treasury Administration was changed into the Ministry of Finance. At this stage the Commercial Court System was issued. That was a preparation for the new era and the formation of the country's financial and commercial institutions. This period lasted for 20 years until the year 1952. During this period, many commercial banks existed in the Kingdom, including the Indo-China Bank which began its activities in the Kingdom in 1947. It continued operations until its branches in the Kingdom were completely Saudised and its name was changed to the Saudi French Bank which still exists today. The Arab Limited Bank came into existence and began operating in the year 1949. Its name was later changed to the Arab National Bank. Similarly the British Bank of the Middle East began operation in the year

1 Ibid, P. 168.

1950 and its name was later changed to the Saudi British Bank.

During this era, the Pakistani National Bank existed as it was founded in the year 1950. Its name was later changed to Al-Jazira Bank. The National Commercial Bank began operation in the year 1948 under the name of Al Kaaki and Ben Mahfouz Company and finally to the National Commercial Bank. These banks were attached to the Ministry of Finance. The ministry was in charge of monitoring and controlling these banks during this period[1].

(3) SOVEREIGNTY OF THE CENTRAL BANK:

This period began in 1952. This is the year of founding the Saudi Arabian Monetary Agency (SAMA). SAMA came into being to make a market full of all the investors' requirements. The monetary authority system came to affirm the position of SAMA as being responsible for the course of action of the banking movement in the country. The banks operating in the Kingdom during that period were multiple and most of them were branches of foreign banks. That movement was accompanied by expansion in investments and an increase in the volume of external commercial dealings. The government set successive developmental plans aimed at promoting the economy. The banks, in response to all the new developments, opened branches all over the Kingdom.

In 1980, the foreign banks operating in the Kingdom were Saudised through the participation of the national capital. Thus, these banks became partnership ventures between the national and the foreign capitals. The banking work flourished during that period. The branches of banks spread in all cities of the Kingdom. The laws and systems governing the work of these banks appeared. During that period, all the commercial banks, whether foreign or local, were

1 Ibid, p.169.

attached to SAMA which was in charge of controlling these banks and monitoring their activities[1].

(4) SPREAD OF ISLAMIC BANKS:

Islamic banks began their activity in the Kingdom of Saudi Arabia in the mid-70s. At the beginning, the Islamic Development Bank (IDB) was established in 1974. It was and still is an international bank. Its membership is restricted to Islamic countries. Then, the Islamic Dar Al Mal Al Islami Company appeared. This was the start of founding many Islamic banks all over the world under the name of Faisal Islamic Bank. This company began exercising some banking investment work based on the Islamic Shariah. That was followed by establishing Al Baraka banking group which is considered the financial arm for Dallah Al Baraka Group.

This company is considered the first organised company that exercised Islamic banking work, and Islamic investment and finance in a modern and expanded way. It is worth mentioning here that these Islamic investment companies did not exercise these banking activities as Islamic banks attached to the Saudi Arab Monetary Institution, but they were organised as commercial companies attached to the Saudi Ministry of Commerce. Following that, most commercial banks in the Kingdom of Saudi Arabia founded Islamic outlets for their banking activities. All of the commercial banks operating in the Kingdom of Saudi Arabia were traditional banks where no Islamic banking services existed. However, after the strong enthusiasm that the concept of Islamic banks received locally and abroad, these commercial banks were obliged to begin Islamic banking operations by opening Islamic outlets within the framework of the commercial bank. These commercial banks are still operating as traditional banks, supervised and monitored by the Saudi Arab Monetary Agency. At the same time they exercise the Islamic banking

1 Abodah, Abdul Majeed Mohammed, *The Banking System in Kingdom of Saudi Arabia*, Riyadh (Saudi Arabia): Public management Institute, 1986, p. 139.

operations through the Islamic outlets founded by them in their banks and branches operating in Saudi Arabia[1].

6.4.2 METHODS OF BANKS CONTROL IN SAUDI ARABIA:

For the purpose of tightening control on the banks operating in the Kingdom of Saudi Arabia, to protect them from troubles, to protect the funds of depositors and contributors, and ensure a good liquidity percentage with the banks, the Saudi Arab Monetary Agency (SAMA) viewed that it was essential to issue a banks control system regulating their work and monitoring their activity. In the absence of distinguished banking experts in the Kingdom of Saudi Arabia during the 60s, SAMA brought a Dutch expert and resorted to the similar systems applied in many countries. The general items of the banks control system in the Kingdom were set. Then the system was issued by virtue of Royal Decree No.5 on June 12th 1966[2]. It is worth mentioning that this system was set on traditional basis similar to the banks control systems in many countries. It did not have an Islamic formula at that time and it was designed to fit the commercial banks operating in the Kingdom of Saudi Arabia, which were all traditional banks at that time. Therefore, when the banks control system was issued, it did not consider any privilege for the Islamic banks. It ignored their existence, activity or expansion all over the Kingdom of Saudi Arabia.

The Saudi banks control system prohibited the Saudi banks from exercising the tasks liable to prejudicing these banks, their stockholders, and those depositing their funds with them. It also prohibited unlicensed persons from exercising any banking work and prevented them from using the word

1 Mehana, Abdel Aziz, *the Saudi Banking Encyclopedia*, Riyadh (Saudi Arabia): Dar El-Helal printing house, 1995 [1st. edition], P. 267.

2 Haji Ali, Mohamed Said, *Saudi Arabian Monetary Agency, Its establishment, Course of action & achievements*, Riyadh (Saudi Arabia): Al-Ayoub printing house, 1991 [1st. edition], P. 287.

'bank', its synonyms or any similar expression in their papers, prints, or trade names.

The Saudi Arab Monetary Agency committed all the banks operating in the Kingdom with its directives concerning the banks control system. If we follow the articles of which the Saudi banks control system is formed, we will find that they do not suit the activities of the Islamic banks operating in the Kingdom under cover of the traditional commercial banks. The articles of this system are suitable for the traditional banks and they are derived from foreign traditional banking systems. The Saudi banking machineries have not permitted the Islamic banks to exercise in a regular manner in the Saudi market until now. They are aware of the existence of Islamic branches or Islamic banks operating under cover of traditional commercial banks, but they shut their eyes to them because of the people's strong zeal and enthusiasm for them.

In his research paper titled "The future for the Islamic Banks in Saudi Markets" submitted to the Islamic banking conference in Riyadh, Governor of the Saudi Arabian Monetary Agency Hamad Al-Sayari talked of the efforts paid to the issue of organising the Islamic banking in Saudi Arabia. He mentioned that until this period there is no permit or license issued from the monetary agency to any entity in Saudi Arabia for providing Islamic banking services in the market. He also mentioned that no Islamic banking law has been issued till this day that can be applied to control or organise the activities of Islamic banking in the Saudi market. He, however, stated that a group of consultants, legal and banking specialists is working for providing the required legislations for organising the Islamic banking in Saudi Arabia. He is optimistic about completing the required laws and regulations in the near future[1].

---

1 Al Sayari, Hamad, *Islamic Banks; current situation and future wailings*, A research presented at the Islamic Banks conference, Riyadh (Saudi Arabia): 24-25 February 2004, pp. 7-13.

The researcher visited the Banks Technical Affairs Department at the Saudi Arabian Monetary Agency and inquired from the manager about the method followed by SAMA in controlling the Islamic branches of the traditional commercial banks operating in the Kingdom. He also inquired about the method adopted in this administration in controlling the other Islamic banks operating as companies attached to the Saudi Ministry of Commerce. As a result of his visit and his discussion with SAMA officials, the researcher reached the following points[1]:

1. The Banks Control Department at SAMA is aware of the existence and operation of Islamic branches for some traditional commercial banks in the Kingdom exercising the business of Islamic banking activities and that the Banks Control Department at the Saudi Arabian Monetary Agency undertakes the monitoring of these banks businesses and controlling their advertisements, and is aware of their products. The SAMA officials are fully aware that the Saudi Jazzira Bank and Al Rajhi Company for Exchange and Investment are two Saudi banks licensed to exercise traditional banking operations compatible with the directives of the Saudi Arabian Monetary Agency. They are aware that these two banks declare to their customers and depositors that they are Islamic banks working completely according to the teachings of the Islamic Shariah. There are other banks like the Saudi American Bank, the Saudi British Bank, the National Commercial Bank, Riyadh Bank and the Arab National Bank doing Islamic banking operations side by side the traditional banking. But they abide by the SAMA directives, particularly with regard to the banks control system and their submission of the required statistical

---

1 On July 5, 2004, the researcher visited Dr. Abdulrahman Al Hameedi, deputy governor for technical affairs in Saudi Arabian Monetary Agency at its headquarters in Riyadh to enquire about the methods followed by the agency in controlling the performance and work of Islamic banks and financial institutions as well as the Islamic branches of the traditional banks.

tables and data according to the forms prepared by SAMA. For as long as these banks abide by the directives and requirements of the Saudi Arabian Monetary Agency, it does not care for the names these banks give themselves or the qualities they are characterised by. The key point is abiding by the directives and requirements requested from these banks by SAMA and presenting their data according to its requirements.

2- The Banks Control Department at the Saudi Arabian Monetary Agency affirms that all commercial banks operating in the Kingdom, including the Islamic dealings divisions in these banks, fully observe the instructions and systems of SAMA, and abide by the percentages required to be deposited in them, the requirements of the legal reserves, the liquidity percentages, and the other conditions connected with exercising their activity, besides fulfilling all required statistical tables and data periodically without any trouble or negligence. These banks, including the Islamic branches, fully abide by the SAMA directives.

3- The Saudi Arabian Monetary Agency does not have an independent control system for Islamic banks or for the Islamic branches of traditional banks, since the Banks Control System of the Saudi Arabian Monetary Agency is a traditional system applied to the traditional banks recognised by SAMA. The Saudi Arabian Monetary Agency does not recognise the existence of Islamic banks authorised to work in the Saudi market even if these Islamic banks actually exist under the traditional banks or under the supervision of and in subordination to the system of the Saudi Ministry of Commerce;

4- SAMA is aware that all the Islamic banks or the Islamic branches of commercial banks conduct Islamic banking operations whether with their customers or depositors or with other banks. These banks implicitly abide by the investment and finance methods compatible with the teachings of the Islamic Shatiah, comprising Murabaha transactions, speculations, manufacturing (Istisna'a), Salam or other transactions. These transactions do not reach SAMA as Islamic investment and finance transactions according to the aforementioned formulae. They reach SAMA as traditional finance transactions in keeping with its instructions and requirements. The employees of the Islamic banks or branches carry out a transformation and translation process to these Islamic transactions as well as their terms and components to present them as traditional transactions before SAMA. What reaches SAMA is a pure traditional finance transaction according to the concepts, instructions, tables and data required by it;

5- The Banks Control Department at SAMA is aware of the existence of Islamic investment and finance companies in the Saudi market exercising banking activities under the cover of the Saudi Ministry of Commerce through the licenses granted to them by the Ministry of Commerce as commercial or investment companies or service companies like Al Baraka Investment and Development Company and Dar Al Mal Al Islami. But it does not recognise these companies as licensed banks. The Saudi Arabian Monetary Agency overlooks the activities of these companies for personal considerations. But from the point of view of the SAMA officials, those companies shall be included in the System of the Saudi Capital Market for which an authority was founded recently for regulating the work of investment and financial trading companies and the stock trading companies and, consequently, these companies shall have a legal cover organising their work and controlling their activity;

In an attempt to identify the opposite point of view as represented by the officials of the Islamic branches and banks operating in the Saudi market, the researcher collected data published by these banks and visited a number of Islamic branches and banks operating in the Saudi market under the cover of the traditional banks. He discussed with them the methods they adopt for matching between the Islamic transactions and the instructions and requirements of SAMA that does not recognise the Islamic banking activities. Most answers of those officials centered on the following points[1]:

1- Although the license granted by the Saudi Arabian Monetary Agency to these banks is for them to conduct banking operations as traditional commercial banks, yet these banks undertake Islamic banking activities for many reasons. A number of important bank customers refrain from dealing in traditional banking transactions because they are prohibited according to the Islamic teaching. These customers requested substituting the traditional transactions by transactions compatible with the Islamic formulae and teachings. There is also a high demand by the bank's customers for the Islamic products upon their introduction.

2- The Islamic branches and banks operating in the Kingdom under cover of the traditional banks abide by the teachings and requirements of SAMA. They are committed to submit all data required by it according to the forms and tables prepared by SAMA despite the difficulty of observing these instructions and requirements because they were not formulated in a form commensurate with the Islamic banks activities;

---

1 Shaif, Abdul Hadi, (Director General of National Commercial Bank in Saudi Arabia), *the Strategic Principles of National Commercial Bank in the Work Of Islamic Banking*, An article in Al Hayat newspaper of London issue no. 15249 on 29 December 2004, page B., and;
Al Ammari, Hassan Salem, (Director General of Al Baraka Company in Saudi Arabia), The experience of Al Baraka Group In Islamic banking In Saudi Arabia, An article in Al Hayat newspaper of London issue no. 15249 on 29 December 2004, page H., and;
Meeting with Mr. Mostafa Kamal, Official of the Islamic transactions in Jezira Bank in Jeddah on 2nd August, 2004 and a meeting with Mr. Farouk Gholam, manager of the Islamic products in the National Commercial Bank of Jeddah on 4 August, 2004.

3- In implementing the SAMA instructions and requirements and in their abidance by the statistical data and tables of the Agency, Islamic banks and branches modify and translate the Islamic finance and investment transactions data to make them compatible with the forms and data prepared by the Saudi Arabian Monetary Agency. The required data are extracted from the Islamic investment or finance transaction, then some terms used in them are substituted by other terms used by the Saudi Arabian Monetary Agency. Consequently, they are submitted to the Saudi Arabian Monetary Agency based on the forms and tables required by them. The compatibility of the Islamic investment and finance transaction with the other requirements of SAMA is observed such as the obligation to maintain the liquidity percentage, the percentage of the legal reserve and other requirements;

4- The non-existence of an Islamic system for monitoring and controlling the Islamic branches and banks operating in the Saudi market leads to confusion and drives these banks and branches to circumvent the SAMA requirements to be able to exercise their Islamic banking activity in the absence of a license or permit by for exercising the Islamic banking operations in the Saudi market;

5- Many of SAMA instructions and requirements are not compatible with the formula of the Islamic banks, rather they contradict their special nature. For example, SAMA prohibits banks operating in the Saudi market from entering into partnership with companies and projects. From the investment point of view, this contradicts the nature of the Islamic banks, which is based on the fundamentals of partnership. If an Islamic system for controlling and monitoring the Islamic branches and banks had existed, it would not have let the Islamic branches and banks use these circumventing methods for exercising Islamic banking. This point is considered one of the disadvantages of the Saudi

Arabian Monetary Agency, knowing that many countries created special systems for the Islamic banks. We find that the cradle of Islamic civilization and the centre of the Islam has been unable to create for itself a comprehensive Islamic banking system compatible with the instructions of the Islamic teaching until today;

6- All Islamic transactions carried out by the Islamic branches or banks are performed through the methods of Murabaha, speculations (Mudaraba), partnerships (Musharakah), Salam, manufacturing (Istisna'a) and leasing (Ijara) that ends with possession and securitisation. The method appropriate for each finance and investment transaction is chosen based on the nature, time and type of this transaction and each of these investment and finance methods has its own nature, conditions and requirements. Consistency thus takes place between the demands of the required investment or finance transaction and the preferred finance and investment method. Consequently, the deeds and contracting agreements are concluded.

6.4.3 GENERAL FEATURES OF THE BASIC ITEMS OF THE SAUDI BANK CONTROL SYSTEM:

Here we will review the basic articles of the Banks Control System at the Saudi Arabian Monetary Agency which was issued by virtue of royal decree No.5 on June 12th 1966[1]. We will analyse these items and show those contradicting the special nature of the Islamic banks and the Islamic banking activity. We will not discuss items comprising definitions of the terms or articles that are compatible with the special nature of the Islamic banks, as long as they are applicable, as they are without any change or substitution, to the Islamic banks. Following are the remarks on a number of items of the banks control system in the Saudi Arabia:

---

1 Haji Ali, Mohamed Said, *Saudi Arabian Monetary Agency, Its establishment, course of action and achievements*, Op. cit., P. 287.

1- Article No. 6 of the Saudi banks control system determined that the bank's liabilities from the deposits shall not exceed 15 times its total reserve and its paid-up or invested capital. If the deposits liabilities exceed this amount, the bank shall increase its capital and reserves to the prescribed level or deposit with SAMA 50% of the excess amount.

Undoubtedly, this article was set for controlling and monitoring the traditional commercial banks to protect the depositors' funds. But the situation with Islamic banks is completely different. The depositor will be a partner of the bank in a transaction and he/she declares to abide by the results of such a transaction. In Islamic banks there are no special deposits, but all funds received by the bank enter in investment transactions on partnership basis between the bank and the depositor. The two parties declare accepting the profit and loss in this investment or finance transaction. Therefore, the Islamic bank does not need to increase its capital and reserves to the level defined by SAMA.

Also, the other solution as mentioned in this article and represented in the necessity of depositing by the bank 50% of the amount exceeding 15 times with SAMA is not compatible with the nature of the Islamic banks. This will mean an important portion of the investors' funds will be inactivated without investment because it will be kept with SAMA.

2- Article No. 7 of the Saudi banks control system stipulated that each bank shall keep for itself a constant deposit of not less than 15% of its deposits' liabilities with SAMA as legal reserve. The monetary agency may modify this percentage whenever it wishes providing it shall not be less than 10% and not exceeding 17.5%. In addition to the deposit prescribed in the previous clause, this article provided that the banks shall maintain a liquidity reserve of not less than 15% of its deposits' liabilities so that this percentage shall be in cash, gold or assets that can be converted into money within a short time. The Saudi Arabian Monetary Agency may also raise this percentage whenever it wishes providing it shall not exceed 20% of the total deposits and this percentage is kept with the same bank. It goes without saying that the legal reserve ratio and liquidity ratio is usually imposed by the central banks on all banks operating under their supervision to protect the depositors' funds. But in the case of the Islamic banks, imposing this percentage contradicts the nature of the Islamic banks because of the following reasons:

a) The relationship between the Islamic bank and its customer is one of partnership based on profit and loss. Once the customer deposits any amount with the Islamic bank, it means that there is a certain investment or finance transaction that this customer enters after reviewing its details and nature, approves it and accepts profit or loss. Besides the bank is delegated for managing and monitoring this transaction. Consequently, the conditions of SAMA for setting this percentage to protect the depositors' funds are not important as long as the Islamic bank does not observe the protection of its customer's capital in any investment or finance transaction except within the limits of transgression or negligence, and as long as sharing the profit or loss is the basis for any operation in which that depositor customer participates with the bank;

b) The Islamic banks acceptance of the conditions of this article in the banks control system means cutting an important portion of the depositors' funds without investing, therefore without realising a return from it. Thus, the level of the customers' profits in the Islamic banks declines for this reason since there is an important part of the investing customer's capital inactivated and retained either with SAMA or in the bank's safes without any investment and without generating investment returns from that part of the capital;

3- Article No. 10 of the Saudi banks control system prohibited any bank from exercising the following tasks:

a) Working for its own interest or with commission by whole or retail sale including importing and exporting trades;

b) Having direct interest as shareholder, partner or owner in any commercial, industrial, or agricultural or any other kind of project;

c) Buying the shares of any bank operating in Saudi Arabia without the approval of SAMA;

d) Holding shares in other joint stock companies established in Saudi Arabia with a value exceeding 10% of its paid-up capital. The nominal value of these shares shall conditionally not exceed 20% of the bank's paid-up capital and reserves;

e) Owning or renting a property unless this is essential for managing the bank's work or for the residence of its employees or their entertainment.

By analysing the items of this article, we find they strongly contradict the nature and characteristics of the Islamic banks for the following reasons:

A. The fundamentals of Islamic investment and finance, require the Islamic banks to undertake certain commercial, import and export operations, where the banks may be obliged to carry out Murabaha transaction for buying a certain product or materials or importing them in favor of one of its customers. This transaction requires that the bank shall enter as party to buying the product or materials that will be subject to the Murabaha transaction, then hold that product or materials with it and consequently sell them to others. These are but commercial operations that are prohibited by the Saudi Arabian Monetary Agency;

B. The nature of the investment and finance transactions exercised by the Islamic bank requires it to contribute to the companies and projects, participate in some, and own other projects and companies whether these are agricultural, industrial, commercial, or service projects or any other activity. The bank's direct investment in the companies and projects, its participation in them or possessing them as a whole is the basis of the Islamic banks' operation. If we review the Islamic investment and finance methods as explained in a previous part of this dissertation, we will know that it is difficult for Islamic banks to exercise their tasks and activities adequately and effectively without entering in contribution or partnership transactions or possessing some companies and projects or a part of them;

C. The Islamic bank entry as financer to any other bank takes place through a number of ways and methods. One of the most important of these is the financer bank's purchase of some shares of the bank requesting the finance for a period of time, then reselling them to the bank which obtained the finance when the sources of settlement become available with it. The process of buying the shares of the borrowing bank is an interim finance transaction that the Islamic bank uses for helping the other banks. Therefore, we find that the Saudi Arabian Monetary Agency's stipulation not to permit any bank to buy the shares of another bank will limit the Islamic bank activity in exercising its duty and diminish one of the important methods it can resort to for financing any other bank within the group of the banking system;

D. The real estate investment and finance is one of the most important fields of investment and finance in the Islamic banks. It is difficult to complete any real estate investment or finance transaction for any customer of the Islamic bank without the bank owning the real estate. The real estate may be used as cover for investment and finance transactions in Islamic banks. If the customer needs finance from the Islamic bank and he/she has property covering the required finance amount or exceeding it with a percentage satisfying the bank, the property may be used as a cover for the Islamic finance transaction. The ownership of this property is transferred to the bank for a period of time in return for the amount of finance required by the customer. Hence, the required amount of finance will be the price with which the Islamic bank buys the property, then the Islamic bank resells it to its customers for a certain price, which is usually higher than the purchase price. Consequently, the customer's purchase price will be the amount equivalent to the settlement of the finance and its profits according to the schedule agreed upon. Therefore, we see that Islamic bank's ownership of real estate is a very important part of the Islamic bank's activities and the Saudi Arabian Monetary Agency's condition stipulating the non-ownership of the real estate by the bank, except within defined limits, contradicts the special nature of Islamic banks.

4- Article No. 11 prohibits any bank from undertaking a number of operations, including holding the shares of any company established outside the Kingdom. This article, and particularly this item, though it is compatible with the traditional banks activity, contradicts the Islamic banks activity. The Islamic banks participate with third parties in projects and companies, whether these projects are within or outside the boundaries of the country in which the bank operates. If we eliminate the partnership activity from the transactions of an Islamic bank, we will restrict the fields of investment and finance available for it. If we follow some of the activities exercised by some Islamic branches and banks operating in the Kingdom, we will find that they performed transactions of possessing shares of companies established outside the boundaries of the Kingdom. Hence, these Islamic banks and branches employ strategies against the Saudi banks control system by various ways and methods for realising their aim in owning the shares of the companies abroad.

5- Article No.15 obliged each bank to send to SAMA a unified monthly statement of its financial standing at the end of the following month, and this statement should be true and correct, and in the form determined by SAMA. The Islamic banks do not object to providing SAMA with any data it requests, but their objection is against the forms this Agency obliges all the Islamic branches and banks to abide by. These forms were designed to suit the data and transactions of traditional banks. The Islamic banks' transactions are totally different from those of traditional banks. Therefore, to fill out the pre-prepared SAMA forms, the Saudi Islamic banks some times insert new terms in these forms or change the terms and data of some Islamic transactions in order to insert them in the forms that are compatible with the SAMA instructions. This change or modification in these data may be explained as misleading the Saudi Arabian Monetary Agency or deliberately submitting incorrect data. Therefore, the officials in charge of the Islamic banks affairs view the necessity that the Saudi Arabian Monetary Agency should prepare other forms for the Islamic banks to allow them to present their data in a proper way and with the names and transactions they basically perform which represent an important part of the activity and business of these Islamic banks;

6- Article No. 16 of the Saudi banks control system restricts the Islamic banks in performing their operations and activities. This article determined several rules by which the banks operating in the Kingdom shall abide. Among these rules are the following:

a) Determining the ceiling of the total loans that one or more banks may offer;
b) Preventing or determining certain types of loans or other dealings;
c) Determining the terms and conditions the banks should observe in their dealing in certain types of operations with their customers;
d) Determining the cash margins that the bank should retain in return for certain types of credits and guarantees;
e) Determining the minimum level of the guarantee percentages to be observed in certain types of loans between the loan amounts and the assets presented as a guarantee for them.
f) Determining the assets that each bank should maintain inside the Kingdom, the value of which may not be less than a percentage of the deposits' liabilities to be determined by the Saudi Arabian Monetary Agency from time to time.

It is noted that applying these rules to the Islamic banks will lead to inactivating an important portion of the investors' and depositors' funds to be retained without investment.

It is noticed that these rules mentioned in this article are considered one of the quantitative and qualitative methods of control on credit that are used by the Saudi Arabian Monetary Agency. Because of the importance of the credit control issue, the Islamic banks may commit themselves to applying these rules, but according to percentages and limits commensurate with their special nature. Therefore, the officials in charge of the Islamic banks affairs view that there shall be a system of Islamic banks control realising for SAMA its target of control on Islamic banks and at the same time realising an understanding of the special nature of Islamic banks.

It must be illustrated here that some of the other articles included in the Saudi banks control system may be in keeping with the nature of the Islamic banks and that these banks should abide by them accordingly. These articles are applicable to the Islamic banks same as they are to the traditional banks. Most of these articles are regulatory and explanatory of the regulations of penalties and fines on all the violations made by the banks in exercising their work in a way contravening SAMA or articles connected with the issues of appointing the board members of the bank and choosing auditors for it.

CONCLUSION:

Islamic banks in many countries have become a reality and an inevitable fact, necessitating the central banks to tighten their control on and monitor them. Many countries have set laws and systems for their central banks commensurate with their controlling and supervisory role with respect to Islamic banks. To shed light upon the role of central bank in controlling the Islamic banks, we analysed the banking system in four different countries. These four countries are Sudan, Iran, Pakistan and Saudi Arabia.

The Sudanese banking system transformation to the codes of the Islamic Shariah passed through several stages that began before independence in 1903. The first stage is the stage of complete usurious banking system wherein the monetary and finance policy is depended on the interest rate mechanism. Then the Sudanese banking system is gradually converted to the Islamic banking system. The banking Law of the year 1991 is considered the law regulating all banking works in Sudan, by virtue of which the banks are licensed to begin their works and activities and all banks and financial institutions operating in Sudan are controlled. Then the performance of their works and activities are monitored and inspected.

There are several quantitative and qualitative tools used by the Sudanese Central Bank in controlling Sudanese banks and, consequently, directing the Sudanese credit and economic activity. These tools are totally compatible with the teaching of Islamic legislation and they play the same role that the conventional tools do, with the same effect to the economy.

While Iran is also considered the first Islamic country binding its economic system with the teachings of the Islamic Shariah. It applied this system to all aspects of the economic life including all banking activities. The Law for Usury-free banking, which was agreed in August 1983, is considered as the main base for establishing, organizing, and operating all the banking activities in Iran. This law contains twenty-seven articles and can broadly be divided into five topics. Four more notes were issued and subsequently became as part of the Usury-Free Banking Law. The controlling system on Islamic banks in Iran, the duties of the Islamic banking system and banking facilities were described and explained in the Law for Usury-free banking and its four notes. It is noticed that the tools used by the Iranian Central Bank in monitoring the banks and normalizing the monetary policy of the country are unconventional tools. But these tools finally lead to tightening the control on banks and controlling the banks' ability to affect the amount of money in the country, and consequently, to affect the conditions of the general economic activities and systems.

We noticed that the Pakistani banking systems passed through three main stages. The first stage is the banking system during the post independence period, then the period of Islamising the banking system, and finally the mixed banking system stage. The report that prepared by the Council of

Islamic Ideology was the basis in issuing the laws regulating the works of Islamic banks and all Pakistani financial institutions. Based on this report the Central Bank of Pakistan set a number of rules and legislations that used for monitoring the performance of work of the Islamic banks and reviewing their activities. The circular No. 13 issued from the Central Bank on 20 June 1984, and its supplements were the main basis that the Central Bank of Pakistan depended on in instituting an effective and progressive law for the banks control system under an Islamic system in the state of Pakistan. Following this circular, other circulars were issued by the central bank, which clarified more details about the Islamic banking basics that were applied in Pakistan where circulars Nos. (26 and 34) issued on 26 November 1984, in addition to the circulars Nos. (37 and 38) issued on 10 December 1984 are considered a supplement to the previous circular No.13 which issued on 20 June 1984 and a clarification of some additional items concerning the Islamic banking works. The Central Bank of Pakistan developed its methods and tools used in controlling and monitoring the banks and financial institutions as time went on.

As for the banking systems in Saudi Arabia, the general items of the banks control system were set, and then the system was issued by virtue of royal decree No.5 in the year of 1966. This system was set on conventional basis. It did not have an Islamic formula at that time. It was designed to fit with the commercial banks operating in Saudi Arabia, which were all conventional banks. Therefore, when the banks control system was issued, it did not consider the Islamic banks. It ignored their existence, activity or expansion all over Saudi Arabia. The Islamic banks began their activity in Saudi Arabia in the mid-70s through the Islamic Development Bank and some other investment companies. These Islamic investment companies did not exercise their banking activities as Islamic banks attached to the Saudi Arabian

Monetary Agency (SAMA), but they were organised as commercial companies attached to the Saudi Ministry of Commerce. Following that most commercial banks in the Saudi Arabia founded Islamic outlets for their banking activities. These banks provided Islamic products through its conventional units.

The Saudi Arabian Monetary Agency does not have an independent control system for Islamic banks or for the Islamic branches of conventional banks. SAMA does not recognise the existence of Islamic banks authorised to work in the Saudi market even if these Islamic banks actually exist under the conventional banks or under the supervision of the Saudi Ministry of Commerce.

After studying and analysing the articles of the Saudi law for controlling Saudi banks we found that this law cannot be suitable for organising or controlling Islamic banks in the Saudi market. Several items in this law have to be changed or modified for controlling or organising the Islamic banks.

CHAPTER 7

CONCLUSIONS AND RECOMMENDATIONS

7.1 CONCLUSIONS:

The researcher came out with findings which confirm the realisation he had at the beginning that:

A. Some of the functions, methods and systems of the present conventional central bank do not agree with the nature of the Islamic banks, and conflict with the nature of Islamic banking system. However, some other parts may suit the Islamic banks after amendments.

B. Through the Islamic economic system which emerges from the Islamic Shariah, we can constitute a framework of the Islamic central bank determining its functions, methods, systems and restraints so that it would be a substitute to the conventional central bank. It would perform the role of the conventional central bank, but in line with the Shariah.

The researcher's findings were based on the results of chapters of this research work, which were as follows:

1. That the origin and development of the conventional banks in the modern age is nothing but an extension and development of the activities of some institutions which functioned in Europe in the Middle Ages. In Europe of the yore traders, usurers and jewellers accepted deposits by issuing nominal deposit certificates determined by a certain interest rate.

2. The banking system in any country consists of several types of banks: commercial banks, specialized banks, and some distinctive banks in some countries, such as the Islamic banks. The central bank is considered one of the

main constituents of the banking system, and heading the banking system hierarchy.

3. The central bank is an independent institution within the framework of a country. It tops the hierarchy of the banking system, draws and implements the suitable monetary and credit policy to achieve economic and national objectives. It is the last resort entity for the banks and financial institutions. It is also the government bank.

4. The central bank is considered a governmental institution having its own independent corporate personality. It works towards drawing and implementing the monetary policies of the country.

5. Islamic bank has a comprehensive definition which determines its features and characteristics, and which differentiates it from other banks. It is a financial institution which practices banking operations without taking or giving interest in line with the teachings of the Islamic Shariah. It works towards collecting funds and savings to have them placed optimally to achieve gratifying investment returns in such a way as to guarantee the achievement of the principles of social interdependence. It contributes to various development fields.

6. The Islamic bank has special features and characteristics which distinguish it from other commercial and conventional banks. These distinctive characteristics are as follows:

   a) Islamic banks are the banks which embody Islamic principles in global compliance.
   b) Islamic banks are financing banks by partnership whose base and support lie in investment.

c) Islamic banks endeavour towards the development of societies and consider overall development as one of their objectives.

7. There are key differences between Islamic banks and conventional commercial banks in terms of objectives, functions of their capital, the bases of their funding, financing and investment. There are differences also in the deposits structure and in the set up of their organisational structure.

8. That the central banking system in practice in most of the Islamic countries is imported from the western banking systems. It is a western specimen transferred to the Islamic countries. This is why there are some functions, methods and instruments which cannot be acceptable from the Islamic point of view under the Islamic economic system. These functions and instruments are:

   a) The commercial papers rediscount operations by central banks. This is not permissible under the Islamic Shariah, because it basically relies on the prohibited usury. This operation is nothing but loans provided by the central bank to commercial banks preconditioning increase therein. The discount rate stands for the interest rate charged by the central bank from commercial banks against the discounts on their commercial papers.

   b) The central bank's lending operations to the commercial banks against a fixed interest rate or against what is known as the bank rate. This again is against the Islamic Shariah, as it overtly relies on the banned usury.

c) The central bank's performance of the open market operations by selling or purchasing stocks in general and the government bonds in particular. This is against the Shariah principles, because this policy relies on interests.

d) The new money issue operation by the conventional central bank is one of a lending semblance since the central bank issues money which is borrowed by the government against a determined and fixed interest rate. This is not permitted by the Islamic Shariah as the lending or the borrowing operations to and from the government itself on the basis of interest are not allowed.

e) The central bank may not place government bonds (the public debt bonds) as they basically rely on the concept of banned usury.

9. Some of the functions and instruments of the conventional central bank can be used under the Islamic economic system after introducing amendments to be in harmony with the Islamic Shariah. After these amendments, they could fit in with the distinctive nature of the Islamic banks of which we mention the following:

a) The use of the legal reserve rate in credit control and orientation would, as an instrument, make it possible to refund the depositors' funds whenever necessary.

b) The use of the liquidity ratio to face the customers' needs and requirements.

c) The use of the maximum credit ceilings method.

d) The central bank's undertaking of clearing operations between the commercial banks and the inter-bank settlement of accounts.

e) The central bank's laying down of organisational rules governing the operations related to the foundation of banks, putting them into operation, and the introduction of some amendments to their legal status.

f) The central bank's undertaking and planning the role of the financial and economic advisor to the government.

g) The central bank's role in the economic and social development operations.

10. The present relationship which links the Islamic banks with the conventional central banks is still unclear in several fields, perhaps the most salient of which is that of the last resort lender and the lending and borrowing operations, in addition to the banking and credit ratios imposed by the central banks. The supervision of the conventional central banks and their control over the operations of the Islamic banks and their activities cannot be done proficiently unless the panels and entities of the central banks are able to understand the operational nature of Islamic banks, their activities and their functions.

11. There are several reasons which make it necessary to create an Islamic central bank. They are:

a) The expansion of Islamic banks in several countries, and the demand and success achieved by the idea.

b) The instruments which are used by the conventional central bank in supervising and controlling the conventional commercial banks are not fit for the

Islamic banks as most of them do not agree with the Islamic Shariah and conflict with the objectives for which Islamic banks have been established.

c) The ignoring by most of the staff members working in the conventional central banks on functional and administrative levels the Islamic banks' operations and activities.

d) The necessity to create an entity which would support Islamic banks, consolidate them and gain them their customers' trust. It would not only provide them with whatever services and support they need but would also act as their last resort entity whenever they need additional liquidity or whenever they face contingencies.

12. That the banking interest is nothing but pre-Islamic usury which has been banned by the Quran, and which the Prophet has advised us against. Therefore, all the operations of the central bank or commercial banks which include the element of interest are rejected by us under the Islamic economic system.

13. That the Islamic central bank has a definition which is derived from the functions it undertakes. It is the independent governmental and financial institution which operates within the framework of a country. It heads the hierarchy of the banking system, draws and implements the monetary and credit policy of the country for the achievement and realisation of the economic and national objectives. It is also the last resort entity for all the banks and financial institutions operating inside and within the boundaries of the country. It is the bank of the government, and on it falls the burden and responsibility of the religiously legal control of all

the banks and the financial institutions which operate under it. All kinds of banks and financial institutions all over the country must be subjected to the authorities of the Islamic Central Bank by complying with its instructions and guidance and by submission to its provisions and laws. The staff members working for the Islamic central banks must be qualified and experienced in the fields of economy and finance. They should also full awareness of the Islamic Shariah so that they could be able to assess and gauge all the operations which take place in the lobbies of the central bank by means of the Islamic Shariah. At the top of the structural and organisational pyramid of the Islamic central bank, there must be a control authority specialized in the religiously regulatory operations. This is the Islamic religious control authority. This authority must be granted all authorities and discretions which can enable it to check and audit all the operations and transactions.

14. The investment and finance methods used in Islamic banks are known as the Islamic Credit Facilities. The methods for investment and finance at the Islamic banks, whether the investment and financing transactions are short or long-term operations, are divided into the following kinds:

a) Modes of profit sharing: This comprises speculation (Mudarabah) and crop sharing (Muzara'a).

b) Modes of partnership: They comprise permanent partnership and decreasing partnership.

c) Modes of trading: This comprises Murabaha transactions, forward delivery transactions (Salam), and manufacturing transactions (Istisna'a).

d) Modes of Lease Transactions: They comprise operational lease and purchasing lease transactions.

e) Other methods for investment and finance used in Islamic banks such as installment sale and direct investments.

15. The central bank in any Islamic country has a major role in determining the proper transactions and methods for granting banking facilities by Islamic banks for each economic activity separately. The central banks impose on all banks under their purview the laws determining the kind of methods proper for each economic activity.

16. The function of the Islamic Central Bank in issuing money and in its management is to be determined by rules which must be heeded, and must neither be ignored nor exceeded, of which are the following ones:

a) That, money - according to Muslim jurists and canonists - is divided into money by creation or nature (gold and silver), and money by usage and convention (the other metallic mints and the likes such as the banknotes).

b) Money, according to Muslim jurists and canonists, stands for anything which has been agreed to be accepted as cash value, even if it is a piece of stone or wood, as they did not fix a certain form or a certain metal for money. For them, consideration is given to the fact that pricing as an element should be made available in money, and that it would be mediation for exchange, payment and storage of value and wealth.

c) That the paper currency - according to Muslim jurists, canonists - is a self-existent currency or cash, which encompasses the ruling provision of gold and silver, subjected to alms (zakat) and also subjected to usury in both its kinds: the preference and the deferred. Thus, the paper money or currency assumes the provisions of money in relation to all liabilities and obligations imposed by the Islamic Shariah.

d) According to Muslim scholars, paper money is considered as assuming several kinds which vary according to the issuing entities in different countries. The Saudi paper money is one kind, and the American paper money is another kind. Each paper currency is a self-independent kind. Therefore, it is subjected to usury in both its forms: the preference and the deferred, exactly as is the case with both gold and silver money.

e) According to Islamic economists, the money issuance operation is only the competence of the Muslim ruler, nobody else being allowed to do this. The ruler has the right to delegate this task to a certain determined entity or trustworthy persons. This would result in the similarity of the units of the money issued so that all the monetary units issued, whether dirhams or dinars or any other currencies, would assume specific and determined forms and weights. Also, the money issue by the authority of the country and under the supervision the ruler, gives the money issued the legal power, and the religiously legislative form, for the country is obligated to facilitate the exchange of the currencies it issues. Furthermore, it would be possible to control the money supply in the market, for the excessive money supply would result in inflation.

f) Islam has emphasised the importance of money preservation and warned against the deceit and falsification operations. It punishes those who would do that, and considers them corruptors because their deceitful operations lead to an increase in the money supply, resulting in inflation. Islam has called upon Muslim rulers to issue new money, similar to the original one, withdrawing the old one when it decays due to frequent handling.

g) The stock of gold, silver and foreign currencies with the Islamic central bank represents a support and strength factor for the local currency, and also for the stability of national economy. That is why many Muslim scholars deem that the Islamic central bank's acquisition of gold, silver and foreign currencies has become a duty dictated by the interest of the Islamic nation in order to give support to its economy and its currency. Moreover, this is considered a source strength and support for the national economy. It is the restrictive factor which limits the authority of the central bank as to exaggerating the money supply or money issue. That is why many Muslim scholars say that the issuing of money by the Islamic central bank is restrained by limits and covered by a certain cover of gold and foreign currencies.

h) The Islamic central bank's method of placing its new money into circulation relies on either lending to the government and the Islamic banks or participating with the Islamic banks. Thus, the Islamic central bank will be able to place the new money by providing interest-free and soft loans at special and specific terms and conditions to the government and to the Islamic banks. The Islamic central bank may use its influence when lending to the government by laying down provisos that it would invest in a certain field of activity or a specific activity, which private companies refrained from. By this, it would respond to the directives of the economic policy of both the central bank and the country. The same applies when providing interest-free loans to the Islamic banks. It will set terms and conditions that would stipulate the necessity of investing them in determined fields of activity which would achieve the public welfare. The central bank's laying down terms and conditions here is of no offense to the Islamic Shariah as, in the end, it leads to the realisation of public welfare, and not to the harvesting of private interest. Furthermore, the Islamic central bank may resort to using the principle of partnership with the Islamic banks to place its new issue of money into circulation. This would take place by opening investment accounts in its name with the Islamic banks. If it wishes to pump in a quantity of money for circulation in society, it would feed those investment accounts belonging to it. The said Islamic banks would then use these balances in their investments. The contrary would take place if and when the central bank wishes to withdraw a quantity of money from circulation. It would then resort to its investment accounts in question, and withdraw from circulation the quantities it wishes, as a result of which the monetary market would restore its balance.

17. The Islamic central bank has an important function as the government's bank, and financial and monetary advisor. Its role, in this aspect, stands as follows:

a) That the Islamic central bank undertakes all the financial operations needed and required by the country or by any of its entities as it is considered the treasury of the government. It opens and holds regular accountancy ledgers and books for each governmental entity, in which it would enter and lodge all accountancy operations. It would receive and retain the country's revenues and would settle all its payments and liabilities, in addition to keeping its funds with it and investing them on its behalf in line with the Shariah.

b) The Islamic central bank manages the balance of the country's assets in terms of foreign currencies and precious metals. The country uses this balance to facilitate its commercial exchange with the other countries. It also uses it as a cover for the money it issues. The Islamic central bank also manages and invests this cash or monetary balance through these channels authorised by the Islamic Shariah to achieve the best profits for national economy, while keeping the stability of the rate of its local currency vis-a-vis the other foreign currencies.

c) The Islamic central bank plays the role of the financial and monetary advisor of the country. It has all the specialised entities and material and human potentials for collecting information and have it examined and analysed, while providing the government with this information when laying down and implementing the financial and economic policies. Furthermore, the Islamic central bank extends its services and advice to the government during the economic agreements and treaties with the other countries. It shall have all the important and necessary information as to the economic activities and systems prevailing in the other countries, together with the advantages and disadvantages or risks of deals with each and every country.

d) That the Islamic central bank is the manager and organiser of the country's public debt, whether in the form of loans to the country from part of individuals or institutions or authorities within the boundaries of the country, or outside it. Under the Islamic economic system, the conventional forms rejected by the country are replaced by Islamic methods. Among them are the uses of fixed interest-free bonds. This shall be based on the principle of profit and loss sharing and the use of the Islamic investment methods such as the profit-sharing, speculation and partnership as an Islamic substitute for lending to the country. It would be possible to resort to the international and major financial institutions and banks which have Islamic transactions branches to borrow from them on the Islamic grounds and methods. But this should be done only in dire need. It is also possible to rely on the advice and guidance of the Islamic central bank for the selection of the best and most suitable of these institutions. Furthermore, the Islamic central bank might undertake the control and monitoring of the country's repayment of these loans until full refund to the titulars.

e) The Islamic central bank is the financer and lender to the government. It can finance the government either through short-term soft interest-free loans to fill in its temporary gaps or medium and long-term loans approved and authorized by the Islamic Shariah, under specific terms and conditions and according to certain agreements. It can also finance the government through partnership. It can enter in partnership with the government in projects which require financing, such as water, electricity and telecom etc. The Islamic central bank would enter into these projects as a partner to the government, out of which it would realise profits and using its shares in eventuating balance in the country's monetary policy. However, according to the provisions of the Islamic Shariah, the Muslim country has no right to borrow except within the narrowest limits and under dire circumstances so that the government would not overburden itself with charges of debts. The government must, before resorting to borrowing, conduct accurate planning operations of its resources and expenditures so that it would ascertain the extent of its ability to repay its liabilities. The Muslim country must, according to the provisions of the Islamic Shariah, first rely on its own revenues from its economic projects, then on other political resources such as capitation taxes and other taxes and duties after which it would resort to borrowing if these sources prove insufficient.

18. Under the Islamic economic system, the central bank is the bank of banks. It supervises them and controls their activity while providing them with support and consolidation. The relationship of the Islamic central bank with other banks operating within the boundaries of the country, is determined by three fundamental relations:

a) Organisational relations.
b) Coordination relations.
c) Lending and financing relations.

19. A set of rules governs the organisational relations between banks operating within the boundaries of the country and the central bank under the Islamic economic system. These rules organise the operations related to the foundation and operation of these banks and amending their legal status. Accordingly, the organisational relationship which connects the central bank with other

banks under the Islamic economic system is determined by the following rules:

a) That a set of restrictions determined by the Islamic central bank regulates and organises the activity of banks operating within the boundaries of the country. These restrictions are:

i. The foundation restrictions: A set of rules and laws regulates and organises the foundation operations of the banks operating within the country.

ii. Management and operating restrictions: A set of rules and laws regulates and organises the banks' operations related to operating and managing the tasks within the country, and their performance of their activities and the management and administration of their investments.

iii. The restrictions related to change in legal status: A set of rules and laws regulates and organises the operations related to the change in the legal status of the banks operating within the country, such as their merger or expansion of their branches or their liquidation etc.

b) That the conventional foundation restrictions used under the conventional banking system can be used as they are under the Islamic banking system. In general, they do not conflict with the principles of the Islamic Shariah, taking into consideration that it is necessary to added the following two points to the foundation restrictions under the Islamic banking system:

i. The introduction of the classification of Islamic banks as one of the constituents of the banking system of the country. Accordingly, the country's banking system shall consist of commercial banks, specialised banks and Islamic banks in addition to the central bank.

ii. The reviewing of the acts of incorporation of each one of the Islamic banks to ascertain that it is in conformity with the provisions of the Islamic Shariah.

c) That most of the conventional restrictions related to management and activity used under the conventional banking system neither contradict the provisions of the Islamic Shariah nor conflict with the characteristics and principles of the Islamic bank. Therefore, they can be used under the Islamic banking system, with the exception of several items in relation to which there are remarks to be made due to their contradiction with the nature of the Islamic banks. There are some exceptions such as:

i. The constitution of the Islamic bank in the form of a joint stock company. It is a procedure which is accepted according to the Islamic Shariah, but it is reproached in that it deprives depositors who own most of the resources of the bank from practicing any of the management and administration rights, while shareholders who own the lesser percentage of the resources of the bank enjoy these rights.

ii. Some of the activities which conventional banking systems prohibit cannot be banned under the Islamic banking system as they form the core of the operating activity of the Islamic banks such as trading in real estates and movables. It would be inconceivable that the Islamic bank would practice its activity without dealing in them. Insuring the deposits under the Islamic banking system must be on the basis of an interdependent method, and not on a commercial basis.

d) The restrictions related to the change in legal status under the conventional banking system can be used under the Islamic banking system as they are not in contradiction with the provisions of the Islamic Shariah. The exception being what is related to the issue of the liquidation of the Islamic banks, as it shall be a must to treat the holders of the investment accounts in Islamic banks as would be treated the shareholders, in such a way that they would not get their rights and profits except after full repayment of all the debts owed to the creditors and to the current accounts holders, since the investment accounts relay on the profit and loss basis.

20. That the coordination between the central bank under the Islamic economic system and the remaining banks operating within the boundaries of the country stands as being:

a) The holding and settlement of the accounts of the member Islamic banks.
b) The undertaking of the clearing accounts of the member banks.

21. That the lending and financing relations between the central bank under the Islamic economic system and the remaining banks operating within the country are represented by the central bank's providing the interest-free financing and funding required by the member banks in times of need by using financing methods which are acceptable according to the Islamic Shariah. They are:

a) Financing by the central bank to the Islamic member banks by using the substitutes and alternatives authorised by the Islamic Shariah can be done through the following:

i. Setting up of a fund to finance the member banks without interests in which all member banks would participate at a certain percentage.

ii. Financing the member banks in need of such funding through the use of the Islamic speculation system. In such case, the central bank shall be the owner of the funds, and the borrowing bank would be the speculator.

iii. Financing the member banks in need of funding by using the interest-free and soft loans.

iv. Purchase some of the shares of the Islamic bank requesting the financing to provide it with the liquidity required.

v. Purchase the shares or issues of projects owned or managed by the Islamic bank requesting the funding or financing.

vi. Use the method of the central lending certificates for the financing of Islamic banks.

b) The Islamic central bank's financing to the Islamic banks on partnership basis such as when the central bank opens investment accounts with the Islamic banks. It uses these accounts to enter into partnership with those banks in their investments so as to create monetary market balance and provide the member banks with the liquidity they need. This falls in two categories:

c) General central deposits: These are the investment deposits by the Islamic central bank with the Islamic banks without fixing the field of activity in which these funds are to be invested.

d) Specialised central deposits: These investment deposits are by the Islamic central bank with the Islamic banks with specific instructions about investment in certain activity or determined projects.

22. The Islamic central bank plays a key role in achieving economic and social development. It aims at:

a) Development of the human resources
b) Expansion in useful and constructive production
c) Improvement of the standard of living
d) Achievement of balanced development
e) Transfer of modern technology
f) Limiting affiliation to other countries

23. That under the Islamic economic system, the central bank is the monitor and controller ever credit. In order to achieve such a control, it uses several criteria:
a) Quantitative control criterion.
b) Qualitative control criterion.
c) Direct control criterion.
d) Religiously valid control.

24. The quantitative control criteria over credit which are used by the central bank under the Islamic economic system are the following:
a) The legal reserve ratio.
b) The liquidity ratio.
c) The method of profit-sharing as a substitute for the interest and discount rates policy.
d) The method of the central deposit certificates.
e) The central borrowing certificates
f) The policy of maximum credit ceilings while replacing the penalty interest rate imposed on the violating banks of this system by a different punitive system.
g) The authorised open market policy by selling and buying governmental bonds which are interest-free and which are based on the profit-sharing principle, in addition to the sale and purchase of the shares of the companies of a permissible activity.

25. The qualitative control criteria over credit which are used by the central bank under the Islamic economic system are the following:

a) Profit-sharing method as a substitute for the preferential interest and discount rates.

b) The method of changing the conditions of the legal reserve.

c) Alteration in the liquidity ratio.

d) Organisation the sale on credit operations.

e) The use of the method of lending restrictions.

f) The use of the method of the partnership share in the cases of financing by partnership, and to guarantee serious intent in the cases of sale by profit-sharing as a substitute to the method of the conventional cash margins.

g) The method of direct restrictions and checks in credit orientation.

26. The following are the direct control criteria in relation to credit and which are used by the central bank under the Islamic economic system:

a) Moral influence and attraction.

b) Persuasion.

c) Obligation.

d) The central bank's undertaking of the banking operations permissible under the Islamic Shariah.

27. The central bank under the Islamic economic system undertakes the religiously valid control task in relation to all the Islamic banks operating within the boundaries of the country. It is done to ascertain that their operations and activities do not conflict with the teachings of the Islamic Shariah. For this purpose

exists an Islamic control authority which determines their functions and tasks.

28. The Sudanese banking system is totally shifted to Islamic banking system. It comprises most of the known Islamic modes of finance and investment, which are as follows:

a) Restricted/unrestricted speculation (Mudarabah).
b) Permanent and decreasing partnership (Musharakah).
c) Profit sharing (Murabaha).
d) Forward transactions (Salam).
e) Manufacturing (Istsna'a).
f) Leasing (Ijara'a).

29. The control and orientation of the banks and the monetary policy in the Sudanese banking system mostly takes place by using two methods and two control tools, namely:

Quantitative Tools. These consist the following:

a) Legal Reserve Ratio.
b) Internal Liquidity Ratio.
c) Central Bank Partnership Certificates (SHAMAM).
d) Government Partnership Certificates (SHEHAMA).
e) Government Finance Bonds (SARH).
f) Investment Outlet Policy.
g) Bridging Liquidity Deficit Gap Policy.

Qualitative Tools:

a) Policy of distributing the financial ceiling between the economic sectors.
b) The policy of determining the share of each Islamic finance instruments from the resources available to the bank.

c) The policy of determining the down payment in Murabaha transactions.

d) The policy of influencing the profits generated from the finance modes.

e) The policy of changing the partnership percentage between the customer and the bank.

30. Iranian banking system is the first in the world to totally shift to Islamic system. Law for usury-free banking, which was agreed in August 1983, is the main base for establishing, organising, and operating all the banking activities in Iran. This law and its annexes comprise all functions and activities that are performed by the central bank within the Islamic framework. This law also comprises the methods adopted by the Central Bank of Iran for controlling the Iranian banks and monitoring their activities.

31. The Iranian banks are allowed to accept two kinds of deposits. These are:

a) Qard al-Hasan deposits: They constitute current and savings deposits which earn no returns.

b) Term investment deposits: They are short-term and long-term investment deposits.

32. The banking facilities that the Central Bank of Iran allowed the Iranian banks to employ are the following:

a) Sale by installments.

b) Civil and legal partnership.

c) Modarabah.

d) Joalah.

e) Forward Transaction (Salam).

f) Qard Hassan.

g) Hire Purchase.

h) Direct Investment.

i) Debt Purchase.

j) Other methods such as Morabaha, manufacturing method (Istisna'a), Wakalah, Mozara'ah, and Mogharasah.

33. The Central Bank of Iran uses several methods in controlling the Iranian banks and implementing the monetary policy in the state. All these methods and tools that it uses are in conformity with the teachings of the Islamic Shariah. By controlling the Iranian banks, the Central Bank of Iran aims at achieving the following targets:

a) Ensuring a safe and secure banking system.
b) Efficient allocation of credit.
c) Protect the customer.
d) Provide a competition.
e) Implement the monetary policy.

34. Pakistan is one of the first Islamic countries that abided by the Islamic teachings in managing its political, economic or social matters. Circular No. 13 issued from the Banking Works Control Department at the State Bank of Pakistan on June 20, 1984, and its supplements are the main bases that the State Bank of Pakistan depended on in establishing, managing and controlling the Islamic Pakistani banks in the country. There are several tools adopted by the State Bank of Pakistan for controlling the Islamic banks and monitoring the monetary policy. These tools are:

a) Legal reserve ratio.
b) Liquidity ratio.
c) The total ceilings of the financing and investment transactions in the banks.
d) Mandatory targets for financing priority sectors.
e) Direct instructions and moral convincing.
f) Determining the percentage of profit sharing.

g) Open market operations. The State Bank of Pakistan substituted the transaction of buying and selling the bonds by an Islamic alternative through issuing bonds with changing profits by the Central Bank of Pakistan.

35. In the Kingdom of Saudi Arabia there are several financial and banking institutions that exist and operate on the teachings of the Islamic Shariah. The Saudi Arabian Monetary Agency (SAMA) does not have an independent control system for Islamic banks or for the Islamic branches of traditional banks. The Banks Control System of the Saudi Arabian Monetary Agency is a traditional system applied to the traditional banks recognised by SAMA, authorised to work in the Saudi market.

7.2 RECOMMENDATIONS

Departing from the conclusions and the results arrived at by the researcher, I would like to include the recommendations which contain all the results of this research work, and which application, I believe, would achieve good results aspired by all Islamic monetary and financial institutions as well as Muslims in general. These would enable those institutions to practice their activities and operations under a system that would appreciate and grasp the circumstances. This system would enable the monetary authorities to achieve a larger efficacy, a more comprehensive and important role in order to include the Islamic banks and financial institutions under the supervision of the monetary authorities as these authorities are in a better position to absorb and understand the Islamic banking activities. Hereunder are these recommendations:

1. That the economic systems in operation in most of the Islamic countries are imported western economic system, which basically rely on the principle of banking interests based on prohibited usury. That is why the researcher recommends against relying on these banking systems in Islamic countries as the nature, circumstances and the environment of Islamic countries differ from non-Islamic states.

2. It has been revealed that the kinds and categories of authorised banks under the banking system in most of the Islamic countries, and which are subjected to the supervision of the central bank are as follows:

   a) Commercial banks.
   b) Investment banks.
   c) Specialised banks.

   The banking regulations accurately determine the characteristics of each category and ratified for each one of them, in most cases, the rules and restrictions related. In addition to this, there are the general rules and regulations which govern them all. This proves that there is a clear and overt relationship between the respective nature of each one of the categories of the banks and the instruments of banking control. Accordingly, the researcher recommends it necessary to take into consideration the characteristics of the Islamic bank to be controlled by central banks.

   A fourth category is added to the types of banks to be approved by the banking regulations in Islamic countries. This fourth category should be allocated to the Islamic banks so that the banking regulations would consecrate a separate and independent part, containing a precise and accurate definition for it.

3. Islamic banks are either functioning or are in the stage of being established in many countries. Many Muslim countries are trying to Islamise their economic and banking systems. But conventional banking system still prevails in the supervision and control of banks. These rules are against the teachings of the Islamic Shariah, so they cannot be applied to Islamic banks. Since in this research work, we have defined Islamic systems, and rules and regulations governing the central bank, the researcher recommends the following:

a) Setting up an Islamic Central Bank in countries having Islamic banks or which wish to establish Islamic banks or those which wish to Islamise their banking and economic systems. The Islamic central bank would perform its tasks, functions and authority under the limits of its activities to achieve economic objectives without conflicting with the Islamic Shariah.

b) The Islamic central bank would exist in either one of the two following forms:

i. A sole Islamic central bank in countries which wish to convert all their economic systems and laws into the Islamic economic system. Since there is no existence of non-Islamic commercial banks under this system, there is no need for a conventional central bank.

ii. An Islamic central bank which would exist side by side the conventional central bank in countries which have joint economic systems, having both conventional commercial banks and Islamic banks or wishing to have Islamic banks. In such a case, the Islamic central bank would control and follow up the Islamic banks, while the conventional central bank controlling and following up the remaining banks. The joint efforts of both central banks would integrate to achieve the economic and banking objectives of the country. It is possible that the central bank would, as one entity, consist of two parts: an Islamic part which would look after the Islamic banks, and a conventional part which would take care of the rest of the commercial banks.

4. The Islamic central bank must undertake several basic functions which, in the end, would lead to the achievement of the economic objectives of the country without contradicting the Islamic Shariah. Amongst these functions are the following ones:

   a) The issue, management and organisation of all affairs related to money.
   b) The bank of the government and its financial and economic advisor or counselor.
   c) The bank of banks, which supervises and controls their activities, while providing them with support and assistance.
   d) Economic and social development of societies in which central banks exist.
   e) Credit control.
   f) Performing any other duty or function which it shall be requested to do, and which, in the end, would achieve the economic objectives of the country.

5. The function of issuing money which must be performed by the Islamic central bank must be set up on the following fundamental bases:

   a) That there would be no application or use of usury in it, in any form whatsoever.

b) The necessity of paying out the alms (zakat) on the banknotes if and when they attain the alms limit.

c) The necessity of keeping its value and having it protected against deceit and fraud.

d) Placing the new issue through the lending of the government and Islamic banks or participation with them.

6. The researcher recommends that the functions of the Islamic central bank, as a bank, financial and economic advisor to the government would rely on the following:

a) Undertaking and performing all the financial operations needed and required by the country or by any of its entities.

b) Playing its role as a country treasury, which would collect its revenues as a whole, and pay its expenses, while managing its balance and assets.

c) Playing the role of the financial and economic advisor to the government.

d) Organising and follow up the public debt of the country.

e) Financing the government and lending it through the methods and channels authorised by the Islamic Shariah.

7. The researcher recommends that the relationship of the Islamic central bank with the Islamic banks under its control should be based on the following:

a) Organisational relations: These encompass the restrictions related to the foundation of those banks, restrictions and checks related to their management and operation, and restrictions connected with changes introduced to their legal status.

b) Coordination relations: These include the operations in between the member-banks, and undertaking inter-bank clearing operations, together with holding their accounts.

c) Lending and financing relations: These include all the operations by means of which the central bank provides loans and financing to member-banks, and which must take place through the use of the Islamic financing, investment and partnership methods.

8. The researcher recommends that the criteria used by the Islamic central bank in performing its function related to controlling Islamic banks and monitoring the credit would be based on the following:

a) Quantitative control tools.
b) Qualitative control tools.
c) Direct control tools.
d) Islamic regulative control.

The researcher also recommends that all these criteria would rely on the Islamic Shariah, which bans and forbids dealing in interests.

9. The researcher recommends that some of the following quantitative control tools can be used by the Islamic central banks for controlling the Islamic banks and monitoring the credit:

a) The legal reserve ratio.
b) The liquidity ratio.
c) Central Bank Partnership Certificates which is on the base of profit-sharing as a substitute to the interest and discount rates policy.
d) The method of the central deposit certificates.
e) The central borrowing certificates.

f) The policy of maximum credit ceilings while replacing the penalty interest rate imposed on the violating banks of this system by a different punitive system.

g) The authorised open market policy by selling and buying governmental bonds which are interest-free and which are based on the profit-sharing principle, in addition to the sale and purchase of the shares of the companies of a permissible activity.

h) Government Partnership Certificates.

i) Government Finance Bonds (SARH).

10. The researcher recommends that some of the following qualitative control tools can be used by the central Islamic banks for controlling the Islamic banks and monitoring the credit:

a) The profit-sharing method as a substitute for the preferential interest and discount rates.

b) The method of changing the conditions of the legal reserve.

c) Alteration in the liquidity ratio.

d) The organisation of the sale on credit operations.

e) The use of the method of lending restrictions.

f) The method of direct restrictions and checks in credit orientation.

g) Policy of distributing the financial ceiling between the economic sectors.

h) The policy of determining the share of each Islamic finance instruments from the resources available to the bank.

i) The policy of determining the down payment in Murabaha transactions.

j) The policy of influencing the profits generated from the finance modes.

11. The researcher recommends that some of the following direct control tools can be used by the Islamic central banks for controlling the Islamic banks and monitoring the credit:

   a) Moral influence and attraction.

   b) Persuasion.

   c) Obligation.

   d) Undertaking the banking operations by the central bank which are permissible under the Islamic Shariah

12. The researcher recommends that the central banks must obligate the Islamic banks to have an Islamic legitimate panel with full authority and unrestricted power to review, control and approve all transactions.

13. The researcher recommends that the credit facilities that can be used in Islamic banks - either in its transactions with the central bank, their clients and the other banks - could be according to the following:

Types of Activity	Permissible Methods
Productive: Industrial Mining Infrastructure Agriculture	Mudarabah, Installment sales, Permanent partnership, Decreasing partnership, Hire purchase, Forward delivery transaction (Salam), Manufacturing (Istisna'a), Direct investment, Qard hassan, Muzarah, Mosaqat, and Jo'alah.
Commercial: Imports Exports Domestic	Mudarabah, Murabaha, Forward delivery transaction (Salam), Installment sales, Permanent partnership, Decreasing partnership, Hire purchase, and Jo'alah.
Services	Installment sales, Mudarabah, Murabaha, Permanent partnership, Decreasing partnership, Hire purchase, and Jo'alah.
Housing: Construction Development Income Generating Properties Repairs	Installment sales, Ijarah, Forward delivery transaction (Salam), Manufacturing (Istisna'a), Direct investment, Permanent partnership, Decreasing partnership, Qard hassan, and Jo'alah.
Personal needs	Installment sales, Forward delivery transaction (Salam), Qard hassan

14. The researcher recommends reference to the chapters of his research work and to the findings for applying the systems of the Islamic central bank, and for achieving its functions as it dealt with in this research work in detail.

APPENDIX 1

Schedule which indicates the establishment dates of the central banks in several world States.

The Year	Name Of The Bank
1922	- The Reserve Bank of Peru (reconstituted under the name of The Central Reserve Bank of Peru in 1931).
	- The Bank of Latvia.
	- The Bank of Lithuania.
1923	- The Bank of the Republic of Columbia.
1924	- The National Hungarian Bank.
	- Bank of Poland.
	- The Commonwealth Bank of Australia (turned into an Australian central bank).
	- The Bank of the Republic of Uruguay (turned into the Central Bank of Uruguay).
1925	- The National Albanian Bank.
1926	- The National Czechoslovakian Bank.
	- The Central Bank of Chile.
	- The Central Bank of Guatemala (reshaped into the Bank of Guatemala in 1946).
1927	- The Central Bank of Ecuador.
	- The Bank of Estonia (converted into a central bank).
1928	- The Central Bank of China.
	- The National Iranian Bank.
	- The Bolivian Central Bank.
	- Bank of Greece instead of the National Bank of Greece.

- The National Bank of Iceland (converted into a central bank

1929 - The National Bank of Yugoslavia (substituting the ex National Bank of Serbia).

1931 - The Central Bank of the Turkish Republic.

1932 - Bank of Mexico turned into a central bank.

1934 - The Reserve Bank of New Zealand.
- The Central Reserve Bank of El Salvador.

1935 - Bank of Canada.
- Indian Reserve Bank.
- Central Bank of the Republic of Argentina.

1936 - The Bank of the Republic of Paraguay (reconstituted under the name of The Bank of Paraguay in 1944).

1937 - The National Bank of Costa Rica.

1939 - The Bank of Afghanistan.

1940 - The Central Bank of Venezuela

1941 - The National Bank of Nicaragua turned into a cent

1942 - The Central Bank of Ireland.
- Bank of Thailand.
- The State Bank of Ethiopia.

1945 - The Polish National Bank (instead of the Bank of Poland).

1947 - The Central Bank of the Dominican Republic.

1948 - The Pakistani State Bank.

- Bank Deutscher Lander (instead of the Reichs Bank in Western Germany).
- The Philippini Central Bank.

1949 - The National Iraqi Bank.

1950 - The Ceylon Central Bank.

- The National Cuban Bank.
- Bank of Korea.
- The Central Bank of Honduras
- The Central Bank of Costa Rica (instead of the National Bank of Costa Rica).
- The German note issue bank : Bank Deutscher Lander

replaced the Reichs Bank in Eastern Germany.

1952 - The Central Bank of the Belgian Congo (replaced by the Monetary Council in 1960 and the National Bank of the Congo in 1964).

- The Union Bank of Burma (turned into a central
- bank)

The Central Bank of Paraguay (instead of the

- Paraguayan Bank).

The Issue Bank of the Federal States of Indo-China (Intersected into the National Banks of

- each of Cambodia, Laos and Vietnam in the year 1955).

The Saudi Arabian Monetary Institution .

1953 - Bank of Indonesia (instead of Bank of Jawa).

1954 - The Bank of Occupied Palestine.

1955 - The National Libyan Bank (renamed The Bank of Libya in 1963).

1956 - The Central Bank of Syria.

- The Central Iraqi Bank (instead of the National Iraqi Bank).
- Bank of Rhodesia and Nyasaland (divided into the Reserve Bank of Rhodesia, the Bank of Zambia, and the Malawian Reserve Bank, in
- 1964).

The Nepalese Central Bank.

1957 - The German Federal Bank: Deutsche Bundesbank (instead of the Bank of German States).

- Bank of Ghana.
- The Central Bank of Surinam.

1958 - The Central Nigerian Bank.

- The Central Bank of Malaya (renamed The Central
- Malaysian Bank in 1963).

The Central Tunisian Bank.

1959 - Bank of Morocco.

- The Australian Reserve Bank (the Bank of the Commonwealth was divided into The Reserve Bank and the Commonwealth Banking Company).
- The Central Bank of the States of West Africa.
- The Central Bank of Equatorial Africa and the Cameron.

1960 - The Bank of the Republic of Guinea.

- The Bank of Sudan.
- Bank of Jamaica.
- The National Somali Bank changed into a central bank

1961 - The Central Bank of Egypt (replaced the National Bank of Egypt).

- The Central Bank of Nicaragua (replaced the Bank of Nicaragua) .
- The Central Iranian Bank (replaced the National Iranian Bank - Bank Melli Iran).
- The Central Icelandic Bank (replaced the National Icelandic Bank).

1962 - The Central Algerian Bank (replaced the National Algerian Bank).

- The Bank of the Republic of Mali.
- The National Ethiopian Bank replaced the State Bank of Ethiopia.
- The Central Jordanian Bank.
- The Bank of Sierra Leone.

1964 - Banque du Liban.

- The Central Bank of Trinidad and Tobago - The Bank of Burundi.
- The National Bank of Ruwanda.

1965 - The Central Brasilian Bank.

- The Bank of Guiana.
- The Central Kenyan Bank.
- The Bank of Tanzania.
- The Bank of Uganda.

1967 - The Central Bank of Uruguay (replaced the Bank of the Republic of Uruguay).

1968 - The Central Maltese Bank.
The Central Malian Bank (replaced the Bank of the Republic of Mali).

1969 - The Central Bank of Kuwait.
- The Central Bank of the Republic of Equatorial Guinea.

1971 - The Central Bank of Gambia.
Concerning the other Arab countries not mentioned in this schedule, we show hereunder a statement of their establishment dates :

1971 - Central Yemeni Bank, in the Yemeni Arab Republic.

1973 - The Bank of Yemen in the People's Democratic Republic of Yemen.
- The Central Mauritanian Bank in the Mauritanian Islamic Republic.
- The Bahrain Monetary Institution.
- The Qatar Monetary Institution.

1974 - The Omani Central Bank in the Sultanate of Oman.

1980 - The Law of the Central Bank of the United Arab Emirates State was promulgated to replace the Monetary Council in the United Arab Emirates State.

APPENDIX 2

List of Islamic Banks and Their Places[406]

No.	Name Of Institution	Country	Incorporation Date
1	Arab Albanian Islamic Bank Sh.A.	Albania	1992
2	Al-Baraka Bank of Algerie	Algeria	1991
3	Muslim Community Co-operative (MCCA)	Australia	1989
4	Kauthar Bank	Azerbaijan	1992
5	ABC Islamic Bank	Bahrain	1985
6	Al Amin Bank B.S.C.	Bahrain	1987
7	Al Baraka Banking Group	Bahrain	N/A
8	Al Baraka Islamic Bank (B.S.C.) E.C.	Bahrain	1984
9	Al Khaleej Finance and Investment	Bahrain	1981
10	Bahrain Islamic Bank B.S.C.	Bahrain	N/A
11	Citi Islamic Investment Bank E.C.	Bahrain	N/A
12	First Islamic Investment Bank. E.C.	Bahrain	1996
13	Gulf Finance House (B.S.C) E.C.	Bahrain	1999
14	International Credit Company	Bahrain	N/A
15	Investors Bank	Bahrain	1997
16	Kuwait Finance House (Bahrain) B.S.C.	Bahrain	2002
17	Noriba Bank B.S.C	Bahrain	2002
18	Shamil Bank of Bahrain E.C.	Bahrain	N/A
19	Liquidity Management Centre B.S.C	Bahrain	2002
20	Accounting and Auditing Orgnization for Islamic Financial Institutions (AAOIFI)	Bahrain	1990

406 Sorce: Islamic Finance Directory 2004, General council for Islamic and finance institutions, Manama (Bahrain): 2004

No.	Name Of Institution	Country	Incorporation Date
21	Al-Arafa Islami Bank Ltd.	Bangladesh	18-Jun.-95
22	Albaraka Bank Bangladesh Ltd.	Bangladesh	30-Apr.-87
23	Islami Bank Bangladesh Ltd.	Bangladesh	13-Mar.-83
24	Prime Bank Ltd. (Islam. Bank Br)	Bangladesh	18-Jul.-95
25	Social Investment Bank Ltd.	Bangladesh	05-Jul.-95
26	Shahjalal Bank Limited	Bangladesh	2000
27	Islamic Finance & Investment Ltd.	Bangladesh	27-Feb.-2001
28	Shamil Bank of Bahrain E.C.	Bangladesh	N/A
29	Bosnia Bank International D.D. Sarajevo	Bosnia/ Herzegovina	2000
30	Islamic Development Bank of Brunei BHD	Brunei	2000
31	Perbadana Tabung Amanah Islam Brunei	Brunei	N/A
32	The Islamic Bank of Brunei BHD	Brunei	N/A
33	Miraj International Investments Limited	Canada	N/A
34	Muslim Investment Group	Canada	N/A
35	Al-Tawfeek Co. for Inv. Funds	Cayman Islands	28-May-92
36	Al Tawfeek Co. For Investment Funds Limited	Cayman Islands	1992
37	Egyptian Saudi Finance Bank	Egypt	1988
38	Faisal Islamic Bank of Egypt	Egypt	1977
39	Islamic International Bank for Investment & Development	Egypt	1980
40	Arab Gambian Islamic Bank	Gambia	1994
41	Guinea Islamic Bank	Guinea	N/A

No.	Name Of Institution	Country	Incorporation Date
42	Al-Barr Finance House	India	06-Mar.-89
43	Al-Ameen Islamic Fin. & Inv. Corp.	India	N/A
44	Bank Syariah Mandiri	Indonesia	N/A
45	PT. Bank Muamalat Indonesia	Indonesia	1992
46	Bank Keshavarzi (Agriculture)	Iran	1980
47	Bank Mellat	Iran	1980
48	Bank Melli Iran	Iran	1927
49	Bank of Maskan	Iran	1937
50	Bank Refah	Iran	1960
51	Bank Saderat Iran	Iran	1952
52	Bank Sanat Va Madan (Industry and Mine)	Iran	1979
53	Bank Sepah	Iran	1925
54	Bank Tejarat	Iran	1980
55	Eqtesad Novin	Iran	2001
56	Export Development of Iran	Iran	1991
57	Karaferin Bank	Iran	1999
58	Parsian Bank	Iran	N/A
59	Saman Bank	Iran	1999
60	Iraqi Islamic Bank for Investment & Development	Iraq	N/A
61	Beit Al-Mal Saving & Investment Co.	Jordan	1983
62	Islamic International Arab Bank PLC	Jordan	N/A
63	Jordan Islamic Bank	Jordan	1978
64	A'ayan Leasing & Investment Co.	Kuwait	1999
65	Al Mal Investment Company	Kuwait	1998
66	Al Muthanna Investment Company	Kuwait	1999

No.	Name Of Institution	Country	Incorporation Date
67	Aref Investment Group	Kuwait	1975
68	First Investment	Kuwait	1997
69	Gulf Tas-Heelat-Co.	Kuwait	N/A
70	International Investment Gropu (IIG)	Kuwait	N/A
71	Kuwait Finance House	Kuwait	1977
72	Kuwait Real Estate Bank	Kuwait	N/A
73	Ossoul Co For Leasing & Finance k.s.c.c.	Kuwait	1999
74	The International Investor	Kuwait	1992
75	The International Leasing & Investment Co.	Kuwait	1999
76	The Investment Dar	Kuwait	1994
77	First Finance	Kuwait	1999
78	Al Baraka Bank Lebanon SAL	Lebanon	1991
79	Bank Islam Malaysia Berhad	Malaysia	1983
80	Bank Muamalat Malaysia Berhad	Malaysia	1999
81	Dallah Al Barakah Malaysia Hold.	Malaysia	N/A
82	Al Wava Mauritania Islamic Bank	Mauritania	1985
83	Islamic Niger Bank for Commerce and Investment	Niger	N/A
84	Al Barakah Islamic Investment Bank	Pakistan	N/A
85	Al Zamin Leasing Modarabah	Pakistan	1992
86	First Al Noor Modaraba	Pakistan	17-Oct.-91
87	First Allied Bank Modaraba	Pakistan	1993
88	Altowfeek Investment Bank Ltd.	Pakistan	30-May.-90
89	B.F. Modaraba	Pakistan	1989
90	B.R.R. International Modaraba	Pakistan	1985

No.	Name Of Institution	Country	Incorporation Date
91	First Consultation Mudaraba	Pakistan	1991
92	First Crescent Modaraba	Pakistan	N/A
93	Fayzan Manufacturing Modaraba	Pakistan	2001
94	First Custodian Modaraba	Pakistan	1994
95	First Elite Capital Modaraba	Pakistan	1991
96	First equity Mudaraba	Pakistan	1992
97	First Fidelity Leasing Modaraba	Pakistan	1991
98	Faysal Bank Ltd.	Pakistan	03-Oct.-94
99	First General leasing Modaraba	Pakistan	1991
100	First Habib Modaraba	Pakistan	1985
101	First Habib Bank Modaraba	Pakistan	1991
102	First Grindlays Modaraba	Pakistan	1987
103	First Hajveri Modarabah	Pakistan	1991
104	First IBL Modaraba	Pakistan	1990
105	First Imrooz Modaraba	Pakistan	1994
106	First Islamic Modaraba	Pakistan	1994
107	First Mehran Modaraba	Pakistan	1990
108	First National Modaraba	Pakistan	1989
109	First Pak Modaraba	Pakistan	1991
110	First Paramount Modaraba	Pakistan	1995
111	First Professionals Modaraba	Pakistan	1991
112	First Prudential Mudaraba	Pakistan	1989
113	First Punjab Modaraba	Pakistan	1993
114	First Standard Investment bank Ltd.	Pakistan	2002
115	First UDL Modaraba	Pakistan	1991
116	Guardian Modaraba	Pakistan	1991
117	LTV Capital Modaraba	Pakistan	1987
118	Meezan Bank Ltd.	Pakistan	1997

No.	Name Of Institution	Country	Incorporation Date
119	Modaraba Al mali	Pakistan	1987
120	Modaraba Al Tejarah	Pakistan	1991
121	Trust Mudaraba	Pakistan	1991
122	Unity Mudaraba	Pakistan	1994
123	Al Aqsa Islamic Bank	Palestine	1999
124	Arab Islamic Bank	Palestine	1995
125	Beit El-Mal Holdings	Palestine	N/A
126	Palestinian Islamic Bank	Palestine	1995
127	Investment House - Qatar	Qatar	N/A
128	Qatar International Islamic Bank	Qatar	1990
129	Qatar Islamic Bank	Qatar	1982
130	Badr - Forte Bank	Russia	1998
131	Al Rajhi Banking and Investment Corp.	Saudi Arabia	1986
132	Al-Jazira Bank	Saudi Arabia	1997
133	Dar Al-Mal	Saudi Arabia	N/A
134	The Islamic Corporation for the Insurance of Investment and Export Credit	Saudi Arabia	N/A
135	Islamic Development Bank	Saudi Arabia	N/A
136	Senegal Islamic Bank	Senegal	N/A
137	Oasis Group Holdings (Pty) Ltd.	South Africa	1996
138	Al Baraka Bank Ltd	South Africa	1989
139	Amana Investment Limited	Srilanka	1997
140	Agricultural Bank of Sudan	Sudan	1957

No.	Name Of Institution	Country	Incorporation Date
141	Al Baraka Bank - Sudan	Sudan	1984
142	Al Gbarb Islamic Bank	Sudan	1984
143	Al Shamal Islamic Bank	Sudan	1985
144	Al Tadamon Islamic Bank	Sudan	1981
145	Animal Resources Bank	Sudan	1992
146	Bank of Khartoum	Sudan	1913
147	Blue Nile Bank	Sudan	1983
148	El Nilein Banking Group	Sudan	1993
149	Export Development Bank	Sudan	N/A
150	Faisal Islamic Bank - Sudan	Sudan	1977
151	Farmers' Commercial Bank	Sudan	1999
152	Financial Investment Bank	Sudan	1997
153	Gedarif Investment Bank	Sudan	1995
154	Habib Bank Ltd.	Sudan	1982
155	Islamic Cooperative Development Bank	Sudan	1983
156	Ivory Bank	Sudan	N/A
157	Mashreq Bank	Sudan	N/A
158	National Bank of Abu Dhabi	Sudan	N/A
159	National Bank of Sudan	Sudan	1981
160	Omdurman National Bank	Sudan	1993
161	Saudi Sudanese Bank	Sudan	1984
162	Savings & Social Development Bank	Sudan	1995
163	Sudan Financial Services	Sudan	N/A
164	Sudanese French Bank	Sudan	1978
165	Sudanese Islamic Bank	Sudan	1982
166	Sudanese Real Estate Bank	Sudan	1966
167	Workers' National Bank	Sudan	1987

No.	Name Of Institution	Country	Incorporation Date
168	Sheikhan Insurance & Reinsurance Co. Ltd.	Sudan	1983
169	Sudanese Bankers Association	Sudan	N/A
170	Faisal Finance (Swtizerland) S.A.	Switzerland	1980
171	Faisal Finance (Switzerland) S.A.	Switzerland	08-Feb-80
172	The Islamic Bank of Thailand	Thailand	N/A
173	Arab Leasing International Finance (ALIF)	Tunisia	N/A
174	Beit El-Tamweel Al-Saudi Al-Tunisi (Best-Bank)	Tunisia	1983
175	Investment House	Tunisia	N/A
176	Tunisie Saudi Financial Leasing House	Tunisia	N/A
177	Beit Iaadat Ettamine Saoudi Tounsi	Tunisia	1985
178	Best Reinsurance Co.	Tunisia	1985
179	Al Baraka Turkish Finance House	Turkey	1984
180	Anadolu Finans Kurumu A.S.	Turkey	1991
181	Asya Finans Kurumu A.S.	Turkey	1996
182	Family Finans Kurumu A.S.	Turkey	N/A
183	Kuveyt Turk Enkaf Finans Kurumu	Turkey	1988
184	Al-Baraka U.S. group	U.S.A	1978
185	BMI Finance & Investment group	U.S.A	Mar-85
186	Khidr Capital Corporation	U.S.A	1995
187	Takaful USA Management Services	U.S.A	Dec-96
188	Abu Dhabi Islamic Bank	UAE	1997
189	Dubai Islamic Bank	UAE	1975
190	National Bank of Sharjah	UAE	1975
191	Dallah Albaraka (UK) Ltd.	UK	24-Nov-93

No.	Name Of Institution	Country	Incorporation Date
192	Dallah Al Baraka (Europe.) Ltd.	United Kingdom	1999
193	Al Baraka Bancorp Inc.	USA	N/A
194	Ameen Housing Co-Operative of California, Inc.	USA	N/A
195	American Finance House - Lariba	USA	N/A
196	Azzad Asset Management	USA	N/A
197	B.M.I. Finance and Investment Group	USA	N/A
198	Guidance Financial Gropu	USA	N/A
199	Islamic Co-Operative Housing Corporation, Ltd.	USA	N/A
200	Khidr Capital Corporation	USA	N/A
201	MSI Financial Services Corporation	USA	N/A
202	Mudarabah Financial Group Inc.	USA	N/A
203	Samad American Holding Corporation	USA	N/A
204	Samad Group, Inc.	USA	1986
205	Islamic Bank of Yemen for Finance & Investment	Yemen	1996
206	Saba Islamic Bank	Yemen	1997
207	Shamil Bank of Yemen & Bahrain	Yemen	N/A
208	Tadamon International Islamic Bank	Yemen	1996

BIBLIOGRAPHY AND SELECTED REFERENCES

Abdel Rassool, Ali, *The Creation of Credit in Commercial and Islamic Banks*, Cairo (Egypt): Islamic Banks Magazine, International Union for Islamic Banks, Rabee' El Thani, 1401H.

Abdul Kader, Mohamed Razif, *The Role of the Central Bank in the Policy, Regulatory and Supervisory Framework of Islamic Banking, in Malaysia*, A research Presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996.

Abdul Mannan, Mohamed, *Abstracts of Researches in Islamic Economics*, Jeddah (Saudi Arabia): International Center for Research in Islamic Economics, King Abdul Aziz University, 1984.

Abdul Mannan, Mohamed, *Why is the Islamic Economics Important? Seven Reasons for Believing*, Jeddah (Saudi Arabia): A Research published by the International Centre for Research in Islamic Economics, September 1982.

Abdul Mejeed, Abdul Fattah, *the Money Economics Together with an Islamic Perspective*, Cairo (Egypt): Al Kamaliyah Publishing, 1989.

Abdullah, Ahmed Ali, *Islamic Banks; Available Instruments of Islamic banks in Financial Markets*, Beirut (Lebanon): Union of Arab Banks, 1989.

Abodah, Abdul Majeed Mohammed, *The Banking System in Kingdom of Saudi Arabia*, Riyadh (Saudi Arabia): Public management Institute, 1986.

Abou Ghouddah, Abdul Sttar, *Decisions of the legitimate committee of al barakah group*, Jeddah (Saudi Arabia): Publications of Dallah Al barakah group, 2003.

Abou Zahrah, Mohamed, *Khatamu'l Nabiyyeen (The Last of the Prophets)*, Cairo (Egypt): Dar El Fiker Al Arabi, 1973.

Adek, Hussein Awang, *An Overview of Islamic Banking in Malaysia*, A research Presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996.

Afar, Mohamed Abdel Moneim *The Economic Policies in Islam*, Cairo (Egypt): International Union for Islamic Banks, 1980.

Ahmed, Ahmed Majzob, *Monetary Policy in Islamic economy*, Makkah (Saudi Arabia): MA thesis submitted to Faculty of legislation and Islamic studies, Um Al Qura University, 1983.

Ahmed, Ahmed Majzoub, *Evaluation of the Sudanese Islamic Banks role in Developing the banking work*, Mekkah (Saudi Arabia): A research presented to Al Baraka Seminar No. 42 concerning the Islamic Economy as held in Mekkah, October 2003.

Ahmed, Khorshed, *Economic Development within an Islamic framework*, A Research published by Islamic Economic Researches Magazine, Jeddah (Saudi Arabia): International Centre for Islamic Economic Researches, 1980.

Ahmed, Mohye El Dine Ahmed, *The Role of the Central Bank in Relation to the Islamic Bank*, A research paper presented to the Islamic Development Bank seminar about the relation of the central bank with the Islamic banks, Jeddah (Saudi Arabia): 1991.

Ajameyya, Mohamed Abdel Aziz, & El Sheeha, Mostafa Roshdi, *Money, Banks and International Economic Relationships*, Beirut (Lebanon): The University Printing and Publishing House, 1982.

Al Ali, Saleh Ahmed, The *social and economic organization in Basrah in the first century Hegira*, Beirut (Lebanon): Dar Al Taleya for printing and publishing, 1969 [2nd edition].

Al Ammari, Hassan Salem, (Director General of Al Baraka Company in Saudi Arabia), The experience of Al Baraka Group In Islamic banking In Saudi Arabia, An article in Al Hayat newspaper of London issue no. 15249 on 29 December 2004.

Al Basheer, Bakur Abdul Raheem, *The Effect of Monetary and Credit policy for Bank of Sudan on the Islamic Banks*, Khartoum (Sudan): Published by Faisal Islamic Bank of Sudan, 1985.

Al Fudailat, Jabr Mahmoud, *Financial Transactions in Islamic legislation,* Amman (Jordan): Published by Arab Acadimy for Financial and banking Sciences, Vol. 1, 1999.

Al Hawari, Sayed, *Mamaana Bank Islami (What is the Meaning of an Islamic Bank)*, Cairo (Egypt): International Union for Islamic Banks, 1982.

Al Heeti, Abbdulrazzak, *Al Masarif Al Islamiyah: Alnazariyah wa Al tatbeek (Islamic Banks, Theory and Practice)*, Amman (Jordan): Dar Osama for publishing and distribution, 1994.

Al Lutah, Sa'eed Ibn Ahmad, *(The Nature of the Bank Under the Capitalistic, Socialistic and Islamic Systems)*, Abu Dhabi (United Arab Emirates): Islamic Banking Conference, 1985 [3rd edition].

Al Mawardi, Abou Ya'la Mohamed, *Al Ahkam Al Soltaniah (The Sultanic Provisions and Rules)*, correction of Mohamed Hamed El Fiki, Beirut (Lebanon): Dar El Fiker, 1974 [3rd. edition].

Al Rasheed, Abdel Aziz, *Efadat al-Sa'el Fi Ahamm Al-Fatawa Wal Masa'el,* Baghdad (Iraq): Al-Rashid Publishing and Distribution House, vol.1, 1980 [2nd edition].

Al Sayari, Hamad, *Islamic Banks; current situation and future wailings*, A research presented at the Islamic Banks conference, Riyadh (Saudi Arabia): Saudi Arabian Monetary Agency, February 2004.

Al Sayed, Atef, *Studies in Economic Development*, Jeddah (Saudi Arabia): Dar Al Majma'a Al Arabi, 1987 [1st. edition].

Al Tamimi, Yahya M. H., *Towards Islmic central bank*, M.A. Thesis, MekKah (Saudi Arabia): Islamic legislation faculty, Um Al Qura University1987.

Al-Asadi, Khalil, *Ketab Al Tayseer Wal Eltebar Wal Tahreer Wal Ekhtebar Fima Yajeb Men Hosn El Tadbeer Wal Tasarrof Wal Ekhteyar*, edited by Abdel Kader Ahmed Tolayhat, Cairo (Egypt): Dar El Fiker El Arabi, 1968 [1st. edition].

Alavi, Waheedullah, *the Impact of new banking system on the instruments of the Monetary and Credit Policy in Iran*, a research presented to the International Seminar and Islamic Banking, Tehran (Iran): June 1986.

Al-Baaly, Abdel-Hamid Mahmoud, *Basics of the Islamic banking transactions: Reality & the future*, Cairo (Egypt): Wahba's Library, 1990.

Al-Bokhari, Mohamed Ibn Ismail, *Saheeh Al-Bukhari (The Authentic Bokhari)*, Beirut (Lebanon): Dar El-Fikr, Vol.3, 1981.

Al-Faisal, Prince Mohammed, *Banks and Insurance in Islam*, Islamic Banks Magazine, Issue No. 73, Cairo (Egypt): International Union for Islamic Banks, 1983.

Al-Futuhi, Mohamed Ibn Ahmad, (known as Ibn Al-Najjar), *Montaha Al-Iradat Fi Jame' Al-Mokne'a Ma'a Al-Tanquih Wal Ziyadat*, edited by Abdel Ghani Abdel Khalek, Cairo (Egypt): Al-Orouba Bookshop, Vol.1, 1961.

Al-Haj Ali, Mohamed Said, *Saudi Arabian Monetary Agency, Its Foundation, March and Achievements*, Riyadh (Saudi Arabia): El-Ayyoubi Press, 1991.

Al-Hassiah, Meloude Jomaa, *Money, Banks and Economic Activity*, Tripoli (Libya): Bulletins of the Scientific Research National Authority, 1990.

Al-Homr, Abdel Malek *The role of the central bank within the framework of an Islamic banking system*, a research presented to the third conference of the Islamic bank, in cooperation with the International Union for Islamic Banks and Dubai Islamic Bank, held in Dubai (UAE): October 1985.

Al-Horani, Ahmad, *Mohadarat Fi Al Nuzum Al Naqdiyah wa Al Masrafiyah (Lectures on the Monetary and Banking Systems)*, Amman (Jordan): Dar Majdalawi for Publishing and Distribution, 1983.

Ali, Haydar, *Dorar Al-Hokkam, Shareh Mejallat Al-Ahkam*, Beirut (Lebanon): El-Nahda Library, 1969.

Ali, Ahmad Majthoob, *The Economic Policy in Islamic Economy*, M.A. Thesis, Mekkaha (Saudi Arabia): Islamic Legislation Faculty, Om El Kora University, 1983.

Al-Jezeiri, Abdul-Rahman, *Al fiqeh ala al mathaheb al arba'a (Jurisprudence according to the four schools)*, Cairo (Egypt): The Greater Commercial Bookshop, Vol.2, 1970.

Al-Karmali, Anastas Mari, *Al-Noquood Al Arabiyah wa Elm El Nommeyyat (Arab Money and the Science of Money Objects)*, Epistles on Money by Al-Balathri, Al-Makrizi and Al-Thahabi, Beirut (Lebanon): Mohamed Amin Dahj publishing, 1939.

Al-Mawdoudi, Aboul Aala *Usury (Al-Reba)*, Arabicized by:Mohamed Assem El-Haddad, Damascus (Syria): Dar El Fiker Al Islami, 1958 [1st. edition].

Al-Najjar, Ahmed, *100 Questions and 100 Answers about Islamic banks*, Cairo (Egypt): International Union for Islamic Banks, 1978.

Al-Serraj, Mohamed Ahmed, *Al Nizam Al Masrafi Al Islami (The Islamic Banking System)*, Cairo (Egypt): Dar Al Thaqafah for Publication and Distribution, 1989.

Amin, S.H., *Islamic Banking and Finance: The Experience of Iran*, Tehran (Iran): Vahid Publications, 1986.

Antaqui, Rizkallah, & Siba'i, Nehad, *Al-Waseet Fi Al Houkok Al Tejariyah Al Bariyah (Al Waseet in land Commercial Rights)*, Damascus (Syria): Al-Ta'awuniyya Press, Vol. 2, 1964.

Aryan, Hossein, *Iran: The Impact of Islamisation of the Financial System*, London (UK): Rodney Wilson, 1990.

Auerbash, Robert D., *Money, Banking and Financial Markets,* New York (USA): Macmillan Publishing Company, 1986.

Auernheimer, Leonardo & Ekelund, R., *The Essentials of Money and Banking*, New York (USA): John Wiley & Sons, 1982.

Basu, S.K., *A Review of Current Banking Theory and Practice,* Calcutta (India): Macmillan, 1978.

Borai, Mohamed Khalil, *Al Noqoud Wa Al Benouk (Money and Banking)*, Cairo (Egypt): Nahdat El Shark Press, 1985.

Burton, Henry J., *Principles of Development Economics,* Englewood Cliffs (USA): Prentice Hall Inc., 1965.

Central Bank of Iran, Law for Usury Free Banking, Tehran (Iran): August 1983.

Central Bank of Iran, *Regulations relating to the granting of bank facilities*, Tehran (Iran): January 4, 1984.

Central Bank of Pakistan, Banking Control Department, Isalmabad (Pakistan): Circular No. 13, Issued on June 20, 1984.

Chapara, Mohammed Omar, *The Monetary and Banking System under an Islamic Economy,* Dubai (UAE): Translated article published in the Islamic Economy Magazine, Vol.43, January; 1985.

Chapra, Mohammed Omar, *Money and Banking in an Islamic Economy,* a research presented at the Makkah Seminar on Monetary and Fiscal Economics in Islam. Held on Makkah (Saudi Arabia): October, 1978.

Chapra, Mohammed Omar, *Towards a fair monetary system,* Translated by Sayyed Mohamed Sukkar, Herndon Virginia

(U.S.A): The Islamic Thought International Institute, 1990 [2nd edition].

Chapra, Mohammed Omer, & Khan, Tariq, *Monetoring and Supervising Islamic Banks*, Jeddah (Saudi Arabia): Islamic Institute for research and Training: Islamic Development Bank, 2000.

Cooper, John, *The Management and Regulations of Banks*, London (UK): McMillan Publishers, 1984.

Dato Ahmed Taiudin Abdul Rahman, *The Operational and Technical Aspects of the Islamic Bank - case, Study of Bank Islam Malaysia Berhad*, A research Presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996.

De Kock, M. H., *Central Banking*, London (UK): Staples press, 1967.

De Kock, M. H. G., *Central Banking*. Translated by Abdel Wahed El Makhzoumi, Beirut (Lebanon): El Tali'a Publishing House, 1987.

Diulio, Eugene, A., *Theory and Problems of Money and Banking*, New York (USA): McGraw-Hill Book Company, 1987.

Donya, Shawki Ahmed, *The Financing of Development Under an Islamic Economy*, Beirut (Lebanon): Al Resalah Establishment, 1404 H.

Donya, Shawqi Ahmed, *Islam and Economic Development*, Cairo (Egypt): Dar Al Fiker Al Arabi, 1979 [1st. edition].

Dudley G. Lucket, *Money and Banking*, New York (USA): McGraw Hill Book Company, 1980 [2nd. edition].

Dunbar, Charles F., *Theory and History of Banking*, New York (USA): G. P. Putnam's Sons, 1901 [3rd. edition].

Egyptian Central Bank, Banks and Credit Law No. 163 of 1957, Articles from 20 to 23, and Article 3 of the Executive Statute of the Law, 1957.

El Bahuti, Ibn Yunes Idris, *Kashaf El Kena'a Ala Matn Al Ekna'a*, Cairo (Egypt): The Mohammedan Sunnah Press, vol.3, 1947.

El Ba'li Abdul Hameed, *Investments and Islamic legislative control in Islamic banks and Financial Institutions*, Cyprus: Published by Faisal Islamic Bank, 1991.

El Bashir, Bakri Abdel Rehim, *The Effect of the Monetary and Credit Policies of the Bank of Sudan on Islamic Banks*, Al Majmo'a Al Arabia Magazine, vol. 12, Khartoum (Sudan), 1985.

El Bei, Abdel Moneim, *The Economy of Money and Banks*, Cairo (Egypt): Al Shareq Al Arabi Press, 1956 [2nd edition].

El Ghazali, Abou Hamed, *Shefa'a Al Ghaleel Fi Bayan Al Shabah Wal Mukhayyal Wa Malek El-Ta'aleel*, edited by Dr. Hamad El Kobees, Baghdad (Iraq): El-Rashad Press, 1971.

El Hawari, Sayed, *The Arab Banking Legislations: A Comparative Study*, Cairo (Egypt): A study presented to the Arab Administrative Sciences Organization, 1972.

El Hendi, Adnan, *Central Banks and Islamic Banks*, A research presented to the Islamic Banks Seminar. The Fact and Practical Application. Held in Amman (Jordan): December 1988.

El Hendi, Adnan, *Islamic Banks; the relationship between central banks and Islamic banks*, Beirut, (Lebanon): publications of Union of Arab Banks, 1989.

El Hendi, Adnan, *The relationship between the Islamic banks and the central banks*, Amman (Jordan): Banks Magazine, 1st. Issue, 1984.

El Jarhi, Moobed, *Towards an Islamic Monetary and Financial System,* Cairo (Egypt): The International Union For Islamic Banks,1982.

El Jassass, Abou Bakr Ahmed Ali, *Ahkamul Kora'an, (The Provisions of the Qoran)*, Cairo (Egypt): Al-Bahiyya Egyptian Press, Vol. 1, 1347 H.

El Kafrawi, Oaf Mahmoud, *Money and Banks under the Islamic System,* Alexandria (Egypt): Dar El Kutoub El Masryea, 1407H.

El Khalidi, Mahmoud, *The Capitalism economic in the view of Islam*, Beirut (Lebanon): Dar Al Jeel, 1984.

El Makrizi, Takeye El Dine, *Al Nuqud Al Islamyah(The Islamic Money)*, Al Najaf (Iraq): Al Haydariyah book shop publications, 1967 [5th.edition].

El Makrizi, Takeye El Dine, *Eghathat Al Oma Bekashf Al Ghumma (Assisting the Nation by Removing Grief and Distress)*, Cairo,(Egypt): Dar Ibn Al Waleed, 1957 [2nd. edition].

El Masri, Rafiq, *Islamic Development Bank*, Beirut (Lebanon): Al Resalah Establishment, 1992.

El Masri, Rafiq, *Elimination of Interest from the Pakistani Economy*, Jeddah (Saudi Arabia): International Center for the

Islamic Economic Researches, King Abdel Aziz University, 1984 [2nd. edition].

El Masri, Samir Hussein, & Hussein, Salah, *Eqtisadiyat Al noqoud wa Al bonouk (Economy of Money and Banking)*, Jeddah (Saudi Arabia): Dar Okaz Printing and Publishing House, 1980[1st edition].

El Mennawi, Mohamed Abdel Raouf, *Money, Measurements and Weights*, edited by Dr. Rajaa Mahmoud Al-Samera'i, Baghdad (Iraq): Al Rasheed Publishing House, 1981.

El Najjar, Ahmed, & others, *100 Questions and 100 Answers on the Islamic Banks*, Cairo (Egypt): International Union for Islamic Banks, 1978 [1st. edition].

El Najjar, Ahmed, *Limaza Nataamal Maa Al Bonouk Al Islamiyah (Why we deal with Islamic Banks)*, a research submitted to the International Union for Islamic Banks in Cairo (Egypt), September 1991.

El Nawawi, Mohye El-Dine Ibn Sharaf Al-Majmou' *Sharh Al-Mohathab, (The Collection of the Explanation of the Educator)*, Cairo (Egypt): Published by Zakarya Ali Youssef, 1970.

El Nawawi, Mohye El-Dine *Riyad Al-Saleheen, (The Gardens of the Good)*, Beirut (Libanon): Al-Ghazali Bookshop, 1982.

El Nouri, Hussein, *Bohoth Qanoniyah Fi Al Benouk (Legal research in Banking)*, Cairo (Egypt): Ain-Shams Library, 1974.

El Rabi'ah, Saoud Mohamed, *Tahweel Al Msref Al rebawi Ela Masref Islami, (The Conversion of a Usurious Bank into an*

Islamic Bank), Kuwait: Center of Al Manshorat, Al Makhtotat Wa al Wathaeq, 1991.

El Razi, Al-Fakhr, *Al-Tafseer Al-Kabeer (The Major Explanation)*, Teheran (Iran): Scientific Books House, 2nd edition, Vol.7, 1981.

El Sanhouri, Abdel Razak Ahmed, *Al-Wasseet Fi Sharh Al Quanoon Al-Madani Al-Mesri (Al-Wasset in the interpretation of the Egyptian Civil Code)*, Cairo (Egypt): Dar Ehya'a Al Turath Al-Arabi, Vol.25, 1987.

El Sayyed Ali, Abdel Moneim, *The Role of Monetary Policy in Economic Development*, Cairo (Egypt): Arabic Institute for Researches and Studies, 1975.

El Shatbi Abou Ishak Ibrahim Ibn Moussa, *Al-E'etessam*, Beirut (Lebanon): Dar El Ma'arefah, 1983.

El Shibani, Mohammed Abdullah, *Development and civilization changes*, Riyadh (Saudi Arabia): Dar Alam El Ketab, 1988.

El Soyouti, Jalal El Dine Abou Bakr, *Kata'a Al Mojadalah End Taghyeer Al Molamalah (Stopping Argument When Changing the Way of Treatment)*, Printed amongst El Hawi Le el Fatawi, edited and commented upon by Mohamed Mohye El Dine Abdel Hameed, Beirut (Lebanon): El-Sadah Press, Vol.3, 1378 H.

El Tabari, Mohammed, Ibn Jareer, *Jame'e Al-Bayan Fi Ta'weel Al-Quor'an (The Collection of Statements as to the Interpretation of the Koran)*, Beirut (Lebanon): Dar Al-Maaref, Vol.7, 1980.

El Tamimi, Yunis, *The relationship between central banks and the Islamic banks*, a working paper presented to the Islamic

Development Bank seminar about the relation of the central bank with the Islamic banks, Jeddah (Saudi Arabia), 1991.

Encyclopedia Britannic, History of Banking, Vol.4.

Encyclopedia of Islamic Banks, Cairo (Egypt): International Union for Islamic Banks, Vol.1&2, 1982.

Euromoney publications, *Islamic Finance; Innovation and Growth*, London (UK): Published by Euromoney Books, 2002.

Faruqi, Jalees Ahmed, *Islamisation of Banking in Pakistan*, Karachi (Pakistan): United Bank Limited, 1984.

Fawzi, Abdel Moneim, *General Finance and Financial Policies*, Beirut (Lebanon): Dar El-Nahdah El-Arabeyya, 1990.

Fouad, Ahmad Amin, *Islamic Banks and Their Control*, Cairo (Egypt): Islamic Banks Magazine, Issued by International Union for Islamic Banks, vol.41, 1983.

Ghattas, Nabeeh, *The Glossary of Expressions of Economy,Money and Business Administration*, Beirut (Lebanon): Librairie du Liban, 1985 [1st. edition].

Gilbert, J. W., *The History, Principles and Practice of Banking*, London (U.K.): G. Beil & Sons Ltd., Vol.1, 1992.

Goldfeld, Stephen M. & Chandler Lester, V.: *The Economics of Money & Banking*, New York (USA): Harper & Row, Publishers, 1985.

Hamed, Sayed Mohamed, *the development of the Central Banking System in the Kingdom of Saudi Arabia*, translated by Hassan Yasseen, Riyadh (Saudi Arabia): General Management Institute, consultations & Researches department, 1979

Hammoud, Sami, *Tatweer Al Aamal Al Masrafiyah bima yatafiq wa Al Sharia Al Islamiyah (Development of Banking Operations in Agreement with the Islamic Shariah)*, Amman (Jordan): Al-Sharq Press, 1982 [2nd edition].

Haron, Sudin and Shanmugam, Bala, Islamic Banking System Concepts and Applications, Sdangor Darual Ehsan (Malaysia): Pelanduk publications, 1997.

Hashem, Ismail Mohamed, *Notes on Money and Banks*, Beirut (Lebanon): El Nahda El-Arabiyya House, 1985.

Haydar, Ali, *Durr Al Hukkam Shareh Majalat Al Ahkam*, translated into Arabic by Fahmi El Husseini, Beirut (Lebanon): El Nahda Library, Vol. 1, 1969.

Hedayati, S. Asghar, *Islamic Banking; the experience of the Islamic Republic of Iran*, A research presented at the International Conference on Islamic Banking, Sydney (Australia): November 1993.

Hefni, Jamal Anwar Mohamed, *the role of the Sudanese banks in the economic development* : Khartoum (Sudan): A practical study on Sudan, Al-Resala printing & publishing house, 1986.

Hidzir, Yahya, *The Monetary Consideration in the Implementation of Islamic Banking in Conventional Environment*, a research presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996.

Holdsworth, William, *A History of English Law*, London (UK): Sweet & Maxwell Ltd., Vol. 8, 1937.

Hoyle, Ken & Whitehead, G., *Money and Banking Made Simple*, London (UK): Heineman publications, 1982.

Ibn Abdin, Mohamed Amin Ibn Omar, *Ibn Abdin's margin, rad al-mehtar ala Al-dor Al-mokhtar, sharh tanweer al-ebsar,* Cairo (Egypt): Mostafa Al-Halabi Printing House, Vol.5, 1966.

Ibn Abdine, Mohamed Amin, *Hashiyat Ibn Abdeen,* Cairo (Egypt): Mostafa El Babi El Halabi Company and press, vol.3, 1386H.[2nd. edition].

Ibn Abdullah, Mohamed, *Ahkam Al-Qura'an,* edited by Ali Mohamed Al-Bejawi, Cairo (Egypt): The Arabic Books Revival House, Vol.1, 1957 [1st. edition].

Ibn Hanbal, Ahmed, *Al-Mosnad,* Beirut (Lebanon): Islamic Office, 1978.

Ibn Kodamah, Abou mohammed Abdullah, *El-Moghni,* Beirut (Lebanon): Arabic Book Publishing and Distributing House, Vol.4, 1392 H.

Ibn Qudamah,Abdullah, *Al Moghni Ma'a Al Sharh Al Kabeer,* Beirut (Lebanon): Arab Book House, vol.2&3, 1972.

Ibn Rushd, Ibn El Waleed Mohamed, *Bedayat Al Mojtahed Wa Nehayat Al Moktased,* Beirut (Lebanon): El Ma'arefah Printing and Publishing House, vol.2, 1401 H.

Ibn Saad, Mohammed, *Al-Tabaquat Al-Kubra (The Big Layers)*, Beirut (Lebanon): Beirut Printing and Publishing House, Vol.3, 1957.

Ibn Taymiya, Ahmed *Al-Kawa'ed Al-Nouraniyya Al-Fikehiya (The Enlightening and Canonic Rules)*. Edited by Mohamed Hamed Al-Fiqui, Cairo (Egypt): Mohammedan Sunnah Press, 1957.

Ibn Taymiyah, Ahmed, *Al-Fatawa (Legal Counsels)*, Beirut (Lebanon): Arab Printing, Publishing and Distribution House, Vol.19, 1398H.

International Association of Islamic Banks, Journal of Islamic Banking and Finance, Karachi, vol. 6, No. 1, January, 1989.

Iqbal, Zubair & Mirakhor, Abbas, *Islamic Banking*, Washington D.C. (USA): International Monetary Fund, March 1987.

Islahi, Abdul Azim, *Economics of thought of Ibn Al Qayyim*, Jeddah (Saudi Arabia): Research Series in English, No. 20, International Center for Research in Islamic economics, 1984.

Islamic Canon Law, Resolution of the Islamic Canon Law, Fifth Session, resolution 6, Islamic world league, Mekkah (Saudi Arabia): Rabe'i Al Thani, 1402H.

Islamic finance Directory 2004, Manama (Bahrain): Published by General Council for Islamic Banks and Financial Institutions, 2004.

Ismail, Abdul Halim, *Islamic Banking in Malaysia*. A research presented at the 7th Expert level Meeting of Central Banks. Monetary Authorities and Islamic Banks, Kuala Lumpur (Malaysia): July 1992.

Ismail, Hassan Mohamed, Islamic *Banks and the Banking System*. A research presented to the banking seminar held by the Arab Banks Union in Khartoum (Sudan): December 1989.

Issa, Moussa Adam, *The Effects of Changes in the Value of Money and How to Tackle Them in Islamic Economy*. Jeddah (Saudi Arabia): Printed and Published by The Development and Researches Department, Dallah Al Baraka Group, 1993 [1st. edition].

Jamal, Mohamed Salah, *Daur Al Bonouk Al Islamiyah Fi Al Tanmiyah Al Iqtisadiyah wa Al ijtemaiyah (The Role of Islamic Banks in the Economic and Social Development)*, Amman (Jordan): publications of the Jordanian Central Bank, 1991.

journalistic circulars of the State Bank of Pakistan, Islamabad (Pakistan), April, 2004.

Kabbara, Abdulrahman Haitham, *Islamic Banks*, Beirut (Lebanon): Publications of Union of Arab Banks, 1989.

Kamel, Saleh Abdullah, *Islamic Banking Activities and the controlling role of central banks*, a research presented at seminar on Islamic Banks: the fact and practical application, Amman (Jordan): December 1988.

Keli, Ba Bakr Mohye El Dine, *The Relationship of the Central Bank with Islamic Banks*, Money and Economy Magazine, the Sudanese Faisal Islamic Bank, Khartoum (Sudan): February 1986.

Khan, Abdu Jabbar, *Non-Interest Banking in Pakistan: Concept, Practice and Evaluation*, Royal Book, Karachi (Pakistan): 1991.

Khan, M. Fahim & other, *Fiscal Policy and Resource Allocation in Islam*, Islamabad (Pakistan): Institute of Policy Studies, 1983.

Khan, M. S., & Mirakhor, A., *The financial system and monetary policy in an Islamic Economy*, Jeddah (Saudi Arabia): A research published in journal of Center for Islamic Economics, King Abdul Aziz University, Vol. 3, 1991.

Khoja, Ezzedine Mohammed, *Instruments of Islamic Investment*, Jeddah (Saudi Arabia): Publications of Dallah Al Baraka Group, 1995.

Kohf, Monther, *Islamic Economy*, Kuwait: Al Qalam House, 1979.

Koreissa, Sobhi Tadros, & El-Aqquad, Medhat Mohamed, *Money Banks; Economic and International Relationships*, Beirut (Lebanon): El-Nahda El-Arabiyya House, 1983.

Koreissa, Sobhi Tadros, & El-Aqquad, Medhat Mohamed, *Money, Banks, Economic and International Relationships*, Beirut (Lebanon): El-Nahda El-Arabiyya House, 1983.

Lemoine, R.J., *Foreign banking systems*, edited by Willis and Beckhart, Paris (France): Henry Holt, 1929.

Mare'i, Abdel Aziz, & Ibrahim, Issa Abdo, *Al Noqoud Wa Al Benouk (Money and Banking)*, Cairo (Egypt): Lajnet El-Bayan El-Arabi Press, 1962 [1st edition].

Mashhour, Amira Abdel-Latif, *Investment in the Islamic Economy*, Cairo (Egypt): Madbouli bookshop, 1991.

Mashuhour, Amira Abdullateef, *Investment In Islamic Economic*, Cairo (Egypt): Madbouli Book Shop, 1991.

Masoud, Ahmed, Daur *A Benouk Al Islamiyah Fi Al Dowal Al Namiyah (The role of Islamic banks in development countries)*, Jeddah (Saudi Arabia): Islamic center for research and training (Islamic Development Bank), 1998.

Mehana, Abdel Aziz, *the Saudi Banking Encyclopedia*, Riyadh (Saudi Arabia): Dar El-Helal printing house, 1995 [1st. edition].

Mohamed, Abdul Halim, *supervision and Examination of Islamic Banking Operations*, A research presented at the symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996.

Mohamed, Assem Al-Haj, *Investment Guarantees of Islamic Banks in Sudan*, Al-Khartoum (Sudan): Publications of the bank of Sudan, 2003.

Mohamed, Nasr El Dine Fadl Al-Mawla, *Al Bonouk Al Islamiyah (Islamic Banks)*, Jeddah (Saudi Arabia): Dar El-Elm for Printing and Publishing, 1985 [1st edition].

Mohareb, Nabeel Sedrah, *Money and Banking Institutions*, Cairo (Egypt): Dar El Nahdah El Arabia, 1968.

Mostafa, Ibraheem, & others, *Al Mujaam Al Waseet, (Intermediate dictionary)*, edited by Arabic Language Assembly in Cairo, Istanbul (Turkey): published by Dar Al Dawah, Vol.2, 1989.

Muslim Ibn Hajaj Al-Nissapuri, *Sahih Muslim (The Authentic Muslim)*, explanation by: Yehya Ibn Sharaf Al-Nawawi, Cairo (Egypt): The Egyptian Press and its Bookshop, Vol.2, 1969.

Mustafa, Abdul Raheem, *Banking System and The Monetary Policy in Sudan*, Um Durman (Sudan): Um Durman Islamic University, 1991.

Naqvi, Sayed Nawab Haider, *Interest Rate and International Allocative Efficiency in Islamic Economy*. A revised version of the research presented at the Makkah Seminar on the Monetary and Fiscal Economics in Islam, held in Makkah (Saudi Arabia): October 1978. Produced by the International Center for Research in Islamic Economics, Jeddah (Saudi Arabia): 1982.

Nasir, Zakariya, *Introduction to the World Bonds Markets*, Kuwait: The Economic Development Kuwaiti Fund, 1979.

Nasir, Zakariya, *Money and Credit in Capitalism and Socialism*. Cairo (Egypt): El Medani Press, 1965.

Nasser, Al Gharib Mahmoud, *Banking control on Islamic banks*, a Ph. D. Thesis presented at the Faculty of Commerce, Cairo (Egypt)p: Ein Shams University, 1991.

Normani, Farhad, & Ali, Rahnema, *Islamic Economic System*, Zed New Jersey (USA): Books Ltd., 1994.

Omar, Hussein *The Economic Expressions Encyclopedia*, Cairo (Egypt): Cairo Bookshop, 1965.

Omar, Hussein, *The Encyclopaedia of Economic Expressions*, Cairo (Egypt): The Modern Cairo Bookshop, 1967.

Parker, J.B., *Banking*, London (UK): The English University Press, 1961.

Pourian, Heydar, *The Problems of Nationalised Islamic Financial System: The Case of the Islamic Republic of Iran*. A research presented at the International conference on Islamic Banking, Sydney (Australia): November 1993.

Qari, Ahmed A., *Majalat Al Ahkam Al Shareyah*, Riyadh (Saudi Arabia): Tihama publishing, 1981 [1st. edition].

Rabwi, Mohamed Ibrahim, *The Central Bank under the Islamic Banking System*, A Working Paper presented to the first deliberation circle about paving the way for the completion of the provisions of Islamic legislation in the economic field in Kuwait. Held in Kuwait from 6-8 February 1993.

Ramadan, Zeyad, *Edarat Al Aamal Al Masrafiyah, (Management of Banking Operations)*, Amman (Jordan): Printed under the sponsorship of the Jordanian University, 1977.

Report of the Islamic Thought Council In Pakistan, *the cancellation of interest in the economy of Pakistan*, Translated by Abdel Aleem El Sayed Mansi, Jeddah (Saudi Arabia): published by the International Centre for the Research on Islamic Economy, King Abdul Aziz University, 1984.

Report on International Development in Banking Supervision, Report no.5., Basle (Switzerland): Prepared and Distributed by the Committee of Banking Regulations and Supervisory Practice, September 1986.

Ridy, R. K., *Al Mujtamaa Al Arabi Fi Marhalet Al Taghyeer (The Arab Society in acountryof Change)*, Translated by Ahmed Abdel Aziz El Najjar, Cairo (Egypt): International Union for Islamic Banks, 1981 [2nd Edition].

Salamah, Abdine *Islamic Banks and the Islamisation of the Banking System in Sudan*, Khartoum (Sudan): Published by Sudanese Faisal Islamic Bank, 1984.

Saudi Arabian Monetary Agency, *Thirty Ninth Annual Report*, Riyadh (Saudi Arabia): Published by Research and statistics Department, Saudi Arabian Monitory Agency, 2003.

Sayers R.S. *Central Banking after Bagehot*, Oxford (UK): the Clarendon Press, 1958.

Sayers, R.S., *Modern Banking*, Oxford (UK): the Clarendon Press, 1967.

Seigal, Barry N., Siegel Barry, N., *Money, Banking and Economy, A Monetarist View,* New York (USA): Academic Press, 1982.

Shafei, Mohamed Zaki, *Introduction to Money and Banking,* Beirut (Lebanon): El-Nahda Printing and Publishing House, 1952.

Shaif, Abdul Hadi, (Director General of National Commercial Bank in Saudi Arabia), *the Strategic Principles of National Commercial Bank in the Work Of Islamic Banking,* An article in Al Hayat newspaper of London issue no. 15249 on 29 December 2004.

Shaker, Fouad, *the Qualitative and Quantitative Control on Credit.* A research presented at the Seminar on the Role of the Financing Institutions in Egypt Organised by the Financial management Egyptian Society, in association with the National Bank of Egypt, Cairo (Egypt): May 1982.

Shehadah, Shawki Ismail, *A l Bonouk Al Islamiyah, (Islamic Banks),* Jeddah (Saudi Arabia): Dar El-Shorouk, 1977 [1st edition].

Siddiqi, Mohammed Najatullah, *Islamic Approach to Money, Banking and Monetary Policy, A Review,* a research Presented at the Makkah Seminar on the Monetary and Fiscal Economics in Islam, held in Makkah (Saudi Arabia): October 1978.

Siddiqi, Mohammed Najatullah, *The Role of the Central Bank in Relation to the Islamic Bank.* A working paper presented to the sub-economic committee of the Supreme Consultancy Committee, working on the completion of the application and implementation of the provisions of Islamic legislation in Kuwait, during the period from 6-8th February 1993.

Siddiqui, Mohammed Najattullah, *Researches on the Islamic Banking System*, Jeddah (Saudi Arabia): Scientific Publication Center, King Abdel Aziz University, 2003.

Siddiqui, Mohammed Najatullah, *Financial Management in Islam; The Central Banks in the Framework of Islamic Work*, Amman (Jordan): The Royal Assembly for the Islamic Civilization Researches, All El Bayt Organisation, Vol.1, 1989.

Sidiqui, Mohammed Najatullah, *Applying the laws derived from the Islamic Legislation on the banking work; A practical study on the Pakistani system*, Jeddah (Saudi Arabia): Scientific publication center, King Abdul Aziz University, 1988 [1st.edition].

Sidiqui, Asrar H., *Practice and law of banking in Pakistan*, Karachi (Pakistan): Royal Book, 1983.

Siegel Barry, N., *Money, Banking and Economy, A Monetarist View*, New York (USA): Academic Press, 1982.

Siegel, Barry, *Money, Banking and Economy, A Monetarist View*, Translated by Taha Abdallah Mansour and Abdel Fattah Abdel Rahman, Riyadh (Saudi Arabia): El-Marrikh House, 1987.

Sudin Haron & Shanmugam, Bala, *Islamic Banking System: Concepts & Applications*, Selngor Darul Ehsan (Malaysia): Pelanduk Publications, 1997.

Suwelam, Mohamed Mohamed, *Ausus Al Tamweel Al Masrafi Fi Al Bonouk Al Islamiyah (The Bases of Banking Financing in the Islamic Banks)*, A research presented at the Participation Investment and Financing Programme, held at the King Abdel Aziz University in Jeddah (Saudi Arabia): December 1980.

Taiudin, Dato Ahmad, *The Operational and Technical Aspects of the Islamic Bank*, Case Study of Bark Islam Malaysia Berhad. A research presented at the Symposium of the Malaysian, Experience in Islamic banking, Kuwait, March 9-12-1996.

Tanash, Ahmed Mahmoud, *The Basis of the Economic Development In Islamic Ideology*, Amman (Jordan): Yarmouk University press, 1991.

The General Authority of Civil and Commercial Articles, and the Civil Circuit, and the Circuit of Personal Status, *The Collection of the Civil Cassation Verdicts,* Cairo (Egypt): The sub-press of the Supreme Court, the year 16, 1966, issue 3 (from October to December 1965).

The Holy Quran.

Ushert, Abott Payson, *The Early History of Deposit Banking in Mediterranean Europe*, Cambridge (UK): Harvard University Press, Vol. 1, 1943.

Usmani, Muhammad Taqi, *An introduction to Islamic Finance*, Karachi (Pakistan): Idaratul Ma'arif, 1998.

Uzair, M., *Central Banking operations in an interest free banking system, Monetary and Fiscal Economics of Islam*, edited by Mohamed Ariff, International Center for Islamic Economics, King Abdul Aziz University, Jeddah (Saudi Arabia): 1982.

Willis, H. P., *Theory and practice of central banking*, New York (USA): Harper Publishing, 1931.

Yosri, Abdel Rahman, *The Economics of Money*, Alexandria (Egypt): The Egyptian Universities Printing House, 1979.

Yusof, Fadzil, *The Legal Aspects of Islamic Banking in Malaysia*, a research presented at the Symposium of the Malaysian Experience in Islamic Banking, Kuwait: March 1996.

Ziauddin Ahmed, & other, *Money and Banking in Islam*, Islamabad (Pakistan): Institute of Policy Studies, 1983.

Ziauddin, Ahmed, and Others, *Fiscal policy and resource allocation in Islam*, Islamabad (Pakistan): Institute of Policy Studies, 1983.

Zuhayli, Wahbah, *Financial Transactions in Islamic Jurisprudence*, Damascus (Syria): Dar Al Fiker, Vol. 1 & 2, 2003.